Development of the Modern U.S. Credit Union Movement 1970-2010

Paul Thompson, CUDE

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Modern U.S. Credit Union Movement
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by Paul Thompson

Author of *The Credit Union Lady: A Novel*

Dedicated to the Volunteers
of the U.S. Credit Union Movement
and to My Wife
Whose Support and Editing Skills
Were Invaluable to This Work

Cover: University of Wisconsin
Credit Union (Author Photo)

Light shines in the darkness for the upright; the righteous are merciful and full of compassion. It is good for them to be generous in lending and to manage their affairs with justice. For they will never be shaken; the righteous will be kept in everlasting remembrance.

Psalm 12: Verses 4-6

You cannot operate a typical credit union without spiritual purpose. You are obliged, whether you know it or not, to have some notion of the brotherhood of man if you would operate a successful credit union.

Credit Union Pioneer Roy Bergengren

The ultimate goal of the credit union movement is that each man should be the master of his economic situation rather than its servant. It is where economics and democracy come together that the credit union can exist; it is to keep those two together that the credit union does exist.

John McCullough

Human service really is the only reason for the existence of our credit unions.

Charles F. Eikel, Jr.

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Chapter 1

Before 1970—Laying the Groundwork

This work covers the decades from 1970 to 2010 that saw sweeping changes in the U.S. economy and the American credit union movement. The era was book-ended by two historic economic events: the Great Inflation of the 1970s and the Great Recession of late 2007-09.

The British historian Arnold Toynbee analyzed world history in terms of "challenge and response." He argued that how a civilization responds to its challenges determines whether it will prosper or go into decline. Credit unions have met many challenges and in overcoming them have been transformed. This transformation has not been without its pains and pitfalls. It has also been accompanied by controversy within and without the credit union movement.

The U.S. credit union movement began in 1908 in Manchester, New Hampshire, with the formation of La Caisse Populaire Ste. Marie (Saint Mary's Cooperative Credit Association), today known as St. Mary's Bank.[1] It served immigrant French-speaking textile mill workers. The building where it had its first office is now America's Credit Union Museum.

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[1] The credit union was formed without benefit of legal sanction. In 1909, New Hampshire passed a special act legalizing the credit union. That same year, Massachusetts passed the first general state credit union law.

A Pratt and Whitney worker uses his United Aircraft Credit Union, East Hartford, Connecticut, 1941. This would have been a larger credit union staffed by paid employees but restricted to "plain vanilla" offerings like passbook savings and small loans. Note the portrait of Edward A. Filene on the wall. (Library of Congress Photo)

The pioneers of the U.S. movement, like Boston philanthropist Edward A. Filene, Roy Bergengren, Tom Doig, and Louise Herring were practical idealists. They saw credit unions as tools of economic justice, as member-governed "peoples banks" serving the workers, farmers, and small businesses neglected by most other financial institutions and subjected to usurious interest rates by loan sharks.

The credit union movement had its first growth spurt in the economic boom of the 1920s, which created the world's first mass consumer market. At that time, consumer credit was largely confined to retail merchants and auto dealers. Banks did almost no consumer lending. Average working

people often had to turn to relatives, pawnshops, or loan sharks for loans. Credit unions offered a reasonably priced alternative. Thanks to promoter and lobbyist Roy Bergengren, who was backed financially by Boston businessman and philanthropist Edward A. Filene, the movement broke out of its New England setting and spread across the United States. When Bergengren began his work in 1920, there were under 200 credit unions. By 1930, there were more than 1,500.[2]

Growth continued even during the Depression, especially after passage of the Federal Credit Union Act in 1934, but the stringencies of World War II halted progress until the war ended in 1945.

The post-war era saw the opening of the "Cold War" with the Soviet Union, fear of nuclear annihilation, the Korean War, the red-scare of McCarthyism, deep-rooted segregation, and racial and religious intolerance. But it also was a time of American economic prosperity. European and Asian economies lay in ruins. The U.S. found itself the world's leading economic power.

"Half the wealth of the world, more than half the productivity, nearly two-thirds of the world's machines are concentrated in American hands," wrote a British historian after a tour of the United States.[3]

Returning troops married their sweethearts and many women who had joined the wartime workforce went back to their traditional roles as homemakers. Birth rates shot up, leading to the demographic "pig in the python," the large baby boomer generation that came of age in the 1960s and 70s. Wages rose and many workers moved up from near poverty levels to middle class status. Demand for consumer goods rose, according to historian Stephanie Coontz.

"Up until 1950 most families' discretionary income did not cover much more than an occasional meal away from home; a

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[2] Dorfman, Mark H., *But for Service: A History of the Credit Union Movement in Pennsylvania,* 1984, Pacul Services, Harrisburg, Pennsylvania, p. 62.

[3] Payne, Robert, cited in *Truman* by David McCullough, Simon and Schuster, p. 733.

beer or two after work; a weekly trip to the movies, amusement park, or beach; and perhaps a yearly vacation, usually spent at the home of relatives," Coontz writes.

"Few households had washing machines and dryers. Refrigerators had only tiny spaces for freezing ice and had to be defrosted once a week. Few houses had separate bedrooms for all the children. But starting in the late 1940s, millions of new houses were built and furnished with conveniences and comforts that would have been unimaginable ten years earlier."[4]

This demand for household goods fueled borrowing. The main challenge for credit unions was attracting enough savings to meet the borrowing needs of their members.

A major activity of the credit union movement was credit union formation. Credit unions could be organized under state law or federal law. (Those chartered under federal law have the phrase "Federal Credit Union," FCU for short, as part of their names.) Either way, it was relatively easy — compared to today — to get a credit union charter. As long as a group was large enough (typically at least three hundred or so, depending on the chartering law) and shared a "common bond" that satisfied the regulator, a handful of people in that group could apply for a charter.

The great majority of credit unions were organized around occupational groups, such as employees of a steel plant or school. There were also credit unions organized around the common bond of residence—living in the same neighborhood or community—or of association—attending the same church or membership in a cooperative or other organization.

Regulators defined common bond rather narrowly, often restricting it to one location such as an industrial plant. One reason was that before computers became common, credit unions kept their records by hand, making larger groups difficult to serve. In addition, before modern credit bureaus, credit unions had no way to judge the financial reliability of

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[4] Coontz, Stephanie, *Marriage, a History*, 2005, Viking Penguin, New York, p. 230.

borrowers except by personal acquaintance, which required a relatively small group. General Motors did not have just one credit union. There were 96 different credit unions serving General Motors employees. In Michigan alone, there were 34 such credit unions.[5]

Because of the tight common bond restrictions, forming new credit unions was the main avenue of growth for the movement. Federal and state credit union regulatory agencies felt it was part of their responsibilities to assist groups to organize credit unions, as did the major trade association, the Credit Union National Association (CUNA), and its affiliated CUNA Mutual insurance company.

In addition, many of the leagues, state trade associations, most of which were members of CUNA, employed field representatives to do the same. At the peak of the organizing in 1954, 2,107 new credit unions were formed (including some in Canada, one of the areas where CUNA was working to expand the movement.)

Jim Jukes recalled his days as a field representative and organizer employed by the Kansas Credit Union League: "We went all over the countryside in my old Ford," he told the Credit Union Times. He organized some 60 credit unions.[6]

From 1945 to 1969, the number of credit unions grew from 8,823 to 23,866. Credit union membership boomed from 2.8 million to 21.6 million. Assets rose from $415.4 million to $15.9 billion.

While the movement was growing rapidly, most U.S. credit unions before the 1970s were little different from their forerunners in the 1920s and 1930s. The average credit union in the mid-1960s had fewer than 800 members and less than half a million dollars in assets. Volunteers ran the typical credit union, with perhaps the assistance of part-time employees. As a credit union approached the half million or

[5] Melvin, Donald J., Raymond N. Davis, and Gerald C. Fischer, *Credit Unions and the Credit Union Industry*, New York Institute of Finance, 1977, p. 15.

[6] "Jukes reflects on nearly four decades of working with credit unions," Credit Union Times, January 5, 2000.

million dollar mark in assets, it often would pay a board volunteer, the treasurer-manager, to run the credit union. Hours were frequently limited.

The credit union was usually located within the premises of its sponsor employer, was often subsidized by the employer, and offered mainly passbook share (savings) accounts and consumer loans.[7]

For example, Texas Credit Union League President Dick Ensweiler's first credit union management job in the 1960s was taking over operation of the ailing Harley Davidson Credit Union in Milwaukee. The credit union was housed in a 12 x 12-foot former guardhouse at the rear of the plant, where it was shaken by the rumble of motorcycles being tested in a subterranean room.

"We had one passbook savings account paying 5%," Ensweiler recalled. "We had personal loans at 1% per month on the unpaid balance. We also had some, not many, real estate loans (first mortgages) at 6% per annum." [8]

"Not only were the books kept by hand, but the (member) ledger cards and passbooks were hand posted. After months and months of weekly payroll deductions, a member would come in and want his passbook caught up![9]

"We also calculated dividends by hand! Had to take out each ledger card, find the low balance for the quarter, go to the next low balance for the quarter, etc., and determine what the dividend would be. Then we ran tapes on an old adding machine. The numbers on the tapes had to equal what was

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[7] Common sponsor subsidies included free or low-cost use of space in the sponsor's premises, accounting assistance and/or computerized services, donated supplies and other procurement services, and allowing credit union volunteers to do credit union work on company time.

[8] Ensweiler, Dick, Interview, 2010.

[9] In a practice invented by credit unions, an employer would agree to automatically deduct savings or loan payments from the member's pay and pass them along to the credit union. The ledger card was the credit union's record of the individual member's account. The member also had a passbook for his or her own record. It would often be lost or get out of date, requiring the credit union to reconstruct it for the member.

posted. The tapes then were given to the examiner from the state regulatory agency to review and verify![10]

"We served employees and immediate family members living under the same roof. When members retired we let them continue to belong, but once they closed their account, or if they never belonged while an employee, they no longer qualified to be included in the field of membership."[11]

The volunteer staff of a small credit union was usually honest and dedicated but often untrained in accounting and other financial matters. As Ensweiler indicated, maintaining accurate member ledger cards and keeping member passbooks up to date, not to mention the general ledger, was time-consuming and errors often crept in.[12]

Percentage of Credit Unions in Various Asset Ranges

(Based on NCUA/CUNA Data)[13]

Asset Range	1965	1970
Under $100,000	44.2%	37.9%
$100,001-500,000	35.2%	35.8%
$500,001-1,000,000	9.7%	11.0%
$1,000,001-5,000,000	9.4%	12.6%
$5,000,001 and over	1.5%	2.7

[10] Ensweiler, Dick, e-mail to author, January 18, 2012.

[11] Ensweiler, Dick, Interview, 2010

[12] The general ledger contains all the financial accounts and statements of a business.

[13] Melvin, Donald J., Raymond N. Davis, and Gerald C. Fischer, *Credit Unions and the Credit Union Industry*, New York Institute of Finance, 1977, p. 106.

Many credit unions relied heavily on their league, their state trade association, to help them sort out and balance their books before the examiners came around, a job that could take a league auditor days.

As evident from the preceding chart, credit union averages concealed a wide range of sizes. The bulk of credit union assets was held by the larger credit unions, especially those above one million dollars in assets. The nation's largest credit union in 1970 was Navy Federal, with more than $162.3 million in assets. The second largest was state-chartered Los Angeles Teachers, with assets of $61.9 million.

Like those two, the larger credit unions tended to serve big employers such as airlines, telephone companies, the armed services, and other federal, state, and local government units that had a stable employment base. They were also among the strongest and fastest growing credit unions.

Regardless of a credit union's asset size, its service offerings were sharply limited. The Depression-era Glass-Steagall Act and other laws and regulations defined the roles of depository institutions. Commercial banks were assigned the role of lending to business and secondarily to consumers. Savings and loans and their New England cousins, mutual savings banks, were the primary mortgage lenders. Credit unions made secured installment loans like car loans, small, unsecured loans, short-term mortgages, and a small number of business loans.

In addition to the range of activities permitted each depository institution, law and regulation set the rates it could charge on loans and pay on savings.

Despite the limits on their services and their generally small size, credit unions had some advantages over other depository institutions and finance companies. Being located in the workplace conveniently close to the members was an advantage. Perhaps even more important were their lower costs that enabled them to offer better rates on most loans and savings. Among the factors yielding this cost advantage were sponsor subsidies, use of unpaid volunteers, the modest wages

paid managers, and not having to pay private stockholder dividends.[14]

These factors helped them to grow faster than more sophisticated institutions although their total assets remained much smaller. However, members often made use of competitors as well as their credit union, especially for services like checking that credit unions did not offer.

Another factor enabling credit unions to compete with more sophisticated financial institutions was their exemption from corporate income taxes, although this was not necessarily the major factor helping to keep their costs down. Unlike commercial banks and stock-owned savings and loans, credit unions cannot raise capital by selling stock. They must set aside capital from their earnings to create reserves and improve their services. The exemption from corporate income taxes makes this task easier.

For credit unions chartered by their state, the laws of their state determine what state and local taxes they must pay. Most states exempt state chartered credit unions from state corporate income tax. Most states impose real property taxes, and about half subject state chartered credit unions to sales or use taxes.

What about the federal corporate income tax? Until 1951, mutual savings and loans, mutual savings banks, and credit unions were exempt from federal corporate income tax because they were considered cooperative, nonprofit institutions. In that year, under pressure from commercial banks and the need to finance the Korean War, Congress removed this exemption for mutual S&Ls and savings banks on the grounds that they had become very similar to profit-seeking corporations. However, Congress preserved the federal credit union tax exemption, which applies to both state and federal charters.

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[14] While volunteers were unpaid, they did receive some compensation in the form of free educational opportunities, attendance at league and other meetings that often included recreational as well as business and educational activities, free meals while doing credit union business, and various psychic awards like being seated at the head table at the credit union's annual meeting.

Section 501(c)(14)(A) of the federal tax code provides the exemption for "credit unions without capital stock, organized and operated for mutual purposes and without profit."

Because most credit unions were small and lacked professional expertise, regulators on both the state and federal level took a "father knows best" approach to regulation. Activities not explicitly permitted by law or that could not be construed to fall under the "incidental powers" necessary to carry out their functions were usually deemed inappropriate for credit unions. Credit union managers and boards, aware they were responsible for the funds of their fellow members, tended to be conservative and risk-adverse.

For state-chartered credit unions, their regulatory agency was usually housed within the same department with bank and thrift regulatory agencies. The federal credit union regulatory agency was shifted from department to department as the years passed. In the years immediately before 1970, it was housed in the Department of Health, Education, and Welfare.

All through this period, credit unions did not have share (deposit) insurance except for a few institutions that belonged to private insurance cooperatives. When a credit union suffered losses, it might correct its financial position by reducing or omitting dividends (interest on savings) to members for a time. There were also instances when sponsors provided financial aid. Fidelity bonds (mostly issued under a CUNA program and, since the early 1970s, by the movement-owned insurer, CUNA Mutual, covered losses due to dishonesty of management or board members.

State credit union leagues hired technical specialists to help troubled credit unions resolve their problems. In addition, most credit union leagues by the 1960s had stabilization funds supported by dues to help ailing credit unions and thus protect member deposits. In the event a credit union was liquidated, the stabilization fund would pay off depositors and try to collect outstanding loans.

Losses to members were minimal, and many credit unions,

especially smaller ones, believed deposit insurance was not needed and would bring added costs and burdensome additional regulation and make it harder to organize new credit unions.[15] As a result, the Credit Union National Association (CUNA), and its member leagues long opposed it. A 1954 CUNA brochure stated that "The issue is freedom vs. bondage."[16]

However, larger federal credit unions believed insurance would help them better compete with institutions that did offer federal protection to depositors. This issue led to the formation of the National Association of Federal Credit Unions (NAFCU) in 1967 to lobby for insurance.[17] As it became clear that Congress was ready to enact a federal program, CUNA reached a compromise with NAFCU to shape the final legislation.

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[15] The Bureau of Federal Credit Unions did a study of all credit union liquidations from 1934 to 1952 and found 80 percent of the credit unions that went out of business returned 100 percent or more of member savings. The 390 credit unions that distributed less than 100 percent had a prorated average loss per member of $3.84. A National Association of Federal Credit Unions (NAFCU) study of federal credit union liquidations from 1934 to 1971 found that of nearly 6,000 liquidated credit unions with total assets of $135.3 million, net losses to members totaled only $1.8 million. See "Credit Union Share Insurance: A Report to Congress," NCUA, April 13, 1983, pp. 5 and 13.

[16] "Why Share Insurance Is Unnecessary and Undesirable," Credit Union National Association, 1954, reproduced in "Credit Union Share Insurance: A Report to Congress," NCUA, April 13, 1983, p. 24.

[17] NAFCU was organized by a group of larger, federally chartered credit unions in California run by the "new breed" of career-conscious, professional credit union managers—a type that would become increasingly important during the period covered by this history. Many of the NAFCU founders were former employees of the Bureau of Federal Credit Unions who were unhappy about CUNA's position on several issues, including CUNA's opposition at the time to federal share insurance. NAFCU became a national organization with its headquarters in Washington, D.C. While its founders pledged cooperation with CUNA, the two organizations have been rivals in some respects, often working together closely, other times parting ways on issues.

The 1970s
Metamorphosis Begins

Chapter 2
An Independent Regulator and Federal Insurance

In the 1970s, legal, economic, and technological developments hastened change in the credit union movement and threw it into direct competition with other financial providers. These factors would increasingly shift the movement's culture from what historian Ian Mac-Pherson has dubbed the "populist credit union"—the small credit union close to its members offering limited services and dominated by volunteers—to what he has termed the "managerial credit union," with a more extended membership, a much wider variety of products and service, and professional management.[18]

This shift would be led by the larger credit unions. Smaller credit unions would follow as they grew or merged. The cultural shift would create strains within the movement as credit unions debated how to incorporate their traditional ideals into the new credit union model. And, as credit unions

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[18] MacPherson, Ian, *Hands Around the Globe: A History of the International Credit Union Movement and the Role and Development of World Council of Credit Unions, Inc.,* 1999, Horsdale & Schubart Publishers, Ltd., Victoria, BC, Canada.

continued to grow in size and as they added new products and services, their competitors would argue they were becoming just like banks and challenge their federal income tax exemption. The credit union movement would have to expend considerable energy and money defending the exemption.

As the decade opened, President Nixon signed a new law on March 10, 1970, sought by the credit union movement that converted the Bureau of Federal Credit Unions, in the Department of Health, Education and Welfare, into an independent federal regulator, the National Credit Union Administration (NCUA).

This acknowledged the importance of credit unions in consumer finance and gave federal credit union regulators a more prominent place among the federal banking agencies.

An administrator appointed by the president headed the new agency. A three-person advisory board assisted him. Herman Nickerson, Jr., a retired Marine general, became the first administrator. He was succeeded by C. Austin Montgomery, who in turn was followed by Larry Connell. Under their direction, federal regulation became a bit less conservative, allowing credit unions to take steps toward becoming full-fledged financial institutions.

Later the decade, in 1978, Congress placed governance of the NCUA under a three-person board. One of the directors was designated chairman by the president and oversaw the operation of the agency. The serving NCUA administrator, Lawrence Connell, a former Connecticut bank commissioner, became the first chairman. P.A. Mack was vice chairman, and Harold A. Black, the third board member.

In another significant development, on October 19, 1970, President Nixon signed a law establishing a federal credit union deposit insurance fund. Like the bank and thrift insurance funds, it covered deposits up to $20,000. In credit union jargon, deposits are known as "shares," since they entitle the member to share in ownership and governance of the credit union. The National Credit Union Share Insurance

Fund (NCUSIF) was placed under the control of the new National Credit Union Administration (NCUA).

Congress made it clear that providing insurance was not an indicator of trouble in credit union land but a way of providing a more level playing field.

As the House Banking Committee reports stated: “Credit unions . . .have maintained an outstanding record of safeguarding member shares. Your committee wishes to make clear that this legislation is designed solely to give credit unions the same insurance afforded other federally chartered financial institutions and should be considered as a reward for the outstanding job performed by credit unions. The legislation in no way is intended to indicate that credit unions are facing a period of monetary difficulty. On the contrary, your committee feels that credit unions are in perhaps their strongest financial condition in history.”[19]

The new law required federally chartered credit unions—which made up more than half of all credit unions—to join the National Credit Union Share Insurance Fund (NCUSIF), but made it optional for state chartered credit unions. Most of those with state charters opted out of the federal scheme at the beginning, but they gradually came into the fold so that by the early 1980s, more than half of state chartered credit unions were federally insured.

To provide an alternative to federal insurance, there were a growing number of private cooperative insurance plans. As a 1983 NCUA report to Congress noted:

“Share insurance was first authorized, but never implemented, in 1940 in New York State. In 1956, Illinois started the first private corporation under special legislation. The first state sponsored program was begun in 1961 in Massachusetts when the Massachusetts credit union share insurance corporation was incorporated and began insuring shares on a voluntary basis. It remains in existence today and is the largest of the 16 state credit union share insurance

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[19] Cited in “Credit Union Share Insurance: A Report to Congress,” NCUA, April 13, 1983, pp. 5-6.

corporations. In 1967, the North Carolina Savings Guaranty Corporation was started—to be followed by the Wisconsin and Rhode Island Share Insurance Corporation, both in 1970."[20]

More and more states began requiring insurance for their state-chartered credit unions, some requiring federal insurance and others permitting a choice. Within the space of the decade, most credit unions had insurance of one kind or another.

Federal deposit insurance went into effect January 1, 1971, for those institutions that qualified for it. News items and advertisements around the nation announced this additional member benefit:

The Mesta Federal Credit Union of New Castle has qualified for federal insurance of members' share accounts up to $20,000, according to George Eden, president of the credit union. The credit union share insurance plan is administered by the National Credit Union Administration, an independent agency of the federal government.

"The Mesta Federal Credit Union was chartered in 1957 for the employees of Mesta Machine Company. It has a membership of 500 with assets totaling $191,000.[21]

Some analysts argue that federal deposit insurance stimulated membership growth. Credit union membership nearly doubled in the 1970s. However, the compounded annual average growth in members in the decade after federal insurance went into effect was only slightly higher than in the previous decade (7.4 percent vs. 7.0 percent.)

Insurance does appear to have accelerated asset growth, particularly for larger federal credit unions, although some economists argue that this was also influenced by the inflation of the 1970s. In the first three years of insurance, deposits in a sample of large federal credit unions increased 73 percent, compared to 56 percent in large federally insured state credit

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[20] Ibid., p. 6.

[21] "Mesta Credit Union Schedules Meeting," New Castle (Pennsylvania) News, March 29, 1971, p. 5.

unions, and 49 percent for non-insured state credit unions of the same size.[22] Much of this growth was due to bigger sums being deposited, because the sort of insurance banks offered now protected credit union savings.

While helping to ameliorate the shortage of funds to meet loan demands, the larger deposits carried a risk for credit unions. If Joe Smith and his wife had $350 in the company credit union earning NCUA's regulatory maximum of 6 percent, they were unlikely to search for more exotic alternatives even though the alternatives might offer a higher return. But if they had $20,000 in a share account and they could get 10 percent in equally safe U.S. Treasury bonds, they might be lured into withdrawing their funds to get the higher return. In short, larger credit unions were now bringing in so-called "hot money" that might flow away if general interest rates rose.

This had happened to commercial banks in the 1960s without greatly affecting credit unions with their much smaller accounts. Economists coined the term "disintermediation" to describe this bypassing by savers of intermediary or "middlemen" depository institutions to invest in more lucrative financial vehicles. Now, with federal deposit insurance, credit unions, especially the larger ones that were attracting most of the bigger deposits, faced the same risk of disintermediation as banks if interest rates rose. This was not an immediate threat in the early 1970s, since Treasury rates were low compared to what credit unions were paying on share accounts. But it would become a problem later in the decade.

While insurance offered a number of advantages, especially in marketing, many credit unionists felt it eroded the do-it-yourself nature of the credit union movement. As an unnamed Utah Credit Union League official was quoted in the 1983 NCUA report to Congress:

"We solved problems without insurance in those days by everybody working harder at preserving the credit unions. Prior to insurance we seldom talked about outright liquidating a

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[22] "Credit Union Liquidity and Share Insurance: A New Dimension," National Credit Union Administration, Research Report No. 9, June, 1974.

credit union. We talked instead of finding the ways to preserve the credit union and expand it and make it grow. We, in short, searched harder for the given cause of the problem and tried to correct it. Perhaps that's one of the shortcomings with insurance programs because I don't see that same feeling on behalf of boards of directors to be so anxious to preserve an unhealthy credit union. Now, with the event of insurance, it seems to me they are more likely to throw in the towel and let the insurance fund take care of the problem"[23]

The NCUA report agreed:

"In effect, functions that had been performed in a variety of ways by many organizations, including Leagues, sponsoring companies, State regulators, and members were now performed at the Federal level. . . . As the NCUA or other insurers took over the workout or stabilization functions (in dealing with problem credit unions), the "can do" spirit of self-help tended to be less needed."[24]

However, while the self-help system clearly had been adequate for credit unions up until 1970, it is an open question whether it would have been sufficient as credit unions moved into new areas of service and as assets grew in coming decades.

Chapter 3

Insurance Helps Trigger

Consolidation of the Movement

The United States is unique in its sheer number of depository institutions. Most countries have a few hundred, with a handful of very large banks dominating the market. The U.S. has thousands of banks, savings and loans, mutual savings banks, and credit unions. That number has diminished with the decades, but is still comparatively great. Our dual chartering system, state and federal is also unique.

[23] Quoted in "Credit Union Share Insurance: A Report to Congress," NCUA, April 13, 1983, pp. 16-17

[24] Ibid., p. 16.

Share insurance helped trigger the beginnings of consolidation in the credit union movement. Not all credit unions that applied for federal insurance received it. The NCUA administrator could withhold insurance from credit unions with inadequate reserves, unsound policies and financial conditions, or unfit management.[25] Credit unions whose applications had been rejected had up to a year to remedy their problems and apply again. If federal credit unions failed to receive insurance, they were forced to liquidate or merge with an insured credit union.

While the overall movement was healthy, the averages concealed a range of strengths and weaknesses.[26] Larger credit unions generally were sound. But some smaller ones were financially and managerially weak or encountered unfavorable conditions such as sponsor failure.

In 1970, on average, five borrowers out of every hundred at federal credit unions were behind in their loan payments by two months or more. Most credit unions had adequate reserves to cover loan losses. But when you looked at the smallest credit unions, with less than $25,000 in assets, an average of 13 to nearly 20 borrowers out of each hundred were delinquent in making timely payments. And if the delinquent loans went bad, the average credit union in this class did not have enough reserves to cover the loss.

During the 1960s, before federal insurance, an average of 300 federal credit union charters were canceled each year, mainly through voluntary or involuntary liquidation, often due

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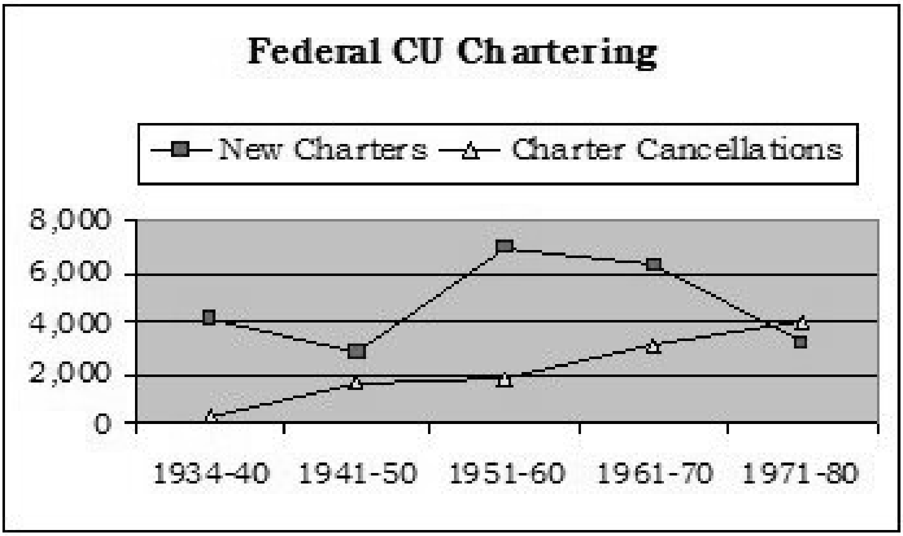
[25] Nickerson, Jr., Herman, "Letter to Boards of Directors of all Federal Credit Unions," October 22, 1970.

[26] Taken together, federal credit unions in 1970 had reserves of 6.3 percent of assets, compared with 7.1 percent for commercial banks. They had a net income equal to 1.3 percent of assets, also known as the return on assets (ROA) ratio. This did not reflect allowance for loan losses, which federally insured credit unions were required to set aside beginning in 1982. That would have brought the ROA down close to 1.0, which is considered a healthy return on assets for a financial institution. In 1970, commercial banks had an ROA of 0.8. State-chartered credit union performance usually tracks closely to federal performance.

to sponsor failures or layoffs. But new charters kept the total number of credit unions rising.

However, the coming of federal insurance put further pressure on credit unions, particularly small ones. NCUA did not want to insure any credit union that might cost the fund later on. So it set insurance requirements higher than many credit unionists believed appropriate. As of May, 1971, 9,356 federal credit unions and 264 state credit unions had been brought under the NCUSIF umbrella, but 303 federal credit unions and 11 state charters had been rejected or deferred.



Data Source: National Credit Union Administration

Credit unionists were unhappy—the Pennsylvania League in November, for example, went to federal district court after 180 of the state's 1,374 federal charters were denied insurance. "We feel certain that when the U. S. Congress passed the law to provide this insurance for credit union member savings, it was not their intent to deprive some of these very members of credit union services," League President Mike Judge declared.[27] The court issued a temporary

[27] "Share Insurance Credit Union Issue," Uniontown, Pennsylvania Morning Herald-Evening Standard, November 18, 1971, p. 15.

injunction prohibiting NCUA from rejecting any more applications.

In response to this discontent, Congress on December 13, 1971, extended the period of probation to two years, rather than one, and provided for provisional insurance coverage for the rejected credit unions in the interim

Nonetheless, some credit unions simply could not qualify. The credit unions that failed to qualify for insurance tended to be "smaller, younger, less well capitalized, more loaned up, less profitable, and less efficient," a Federal Reserve study later concluded. "In addition, each credit union's field of membership was typically so narrowly defined that credit unions were precluded from achieving much diversification across either their borrowers or their savers."[28]

Chartering of new credit unions continued, but requirements were tightened by regulators to protect the federal and state insurance funds. The National Credit Union Administration also slightly relaxed its common bond requirements to make it easier for a credit union to merge with another credit union rather than liquidate.

The chartering of federal credit unions kept up with the attrition rate until the end of the 1970s, but the 1980s would see a steady decline in the number of federal charters as even more relaxed field of membership rules allowed easier mergers and permitted many groups to join an existing credit union rather than charter their own.

In the case of state credit unions, charter cancellations, mergers, and conversion to federal charters outpaced new charters starting in 1970. Taking federal and state charters together, the total number of credit unions in the United States declined steadily after peaking in 1969 at 23,866. Thus, due to changing laws and regulations, the prophecy of credit union pioneer Roy Bergengren that there would eventually be 100,000 credit unions in the U.S. proved to be mistaken. But

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[28] Wilcox, James A., "Credit Union Failures and Insurance Fund Losses: 1971-2004," Federal Reserve Board of San Francisco Economic Letter 2005-20, August 19, 2005.

credit unions would find other avenues of growth in the 1970s and 80s.

A credit union did not face these challenges alone. Credit unions had been joining together to tackle problems since the 1930s. Most were members of state trade associations known as leagues. Leagues, in turn, commonly were members of the Credit Union National Association (CUNA) founded in 1934. There were various factions outside the CUNA-affiliated hierarchy, but some 91 percent of credit unions were affiliated with leagues that were members of CUNA.

After World War II, CUNA had been active in Canada and other places around the world, organizing credit unions, and in recognition of that role, had changed its name to CUNA International. But with growing challenges at home and the increasing maturity of the foreign movements it shepherded, in 1970 it spun off its international responsibilities to a new organization, the World Council of Credit Unions, which became the apex organization of the world's national and regional credit union organizations. The Americans who helped guide the creation of the World Council included R.C. Morgan of Texas and R.C. Robertson of Arizona. The U.S. association became plain CUNA once more.

Shortly after, CUNA gained new leadership by naming Herbert G. Wegner managing director in 1971[29] Herb Wegner had spent seven years as head of CUNA International's Latin America division. A former Navy pilot, he was a flamboyant, charismatic leader devoted to modern management techniques such as "management by objectives."

Wegner reorganized CUNA, and under his guidance it added services to assist credit unions through an increasingly turbulent time. It was an interesting period to be in credit union work, not only because of the fast-changing financial landscape but because credit unionists still saw themselves as a world-changing force.

As Wegner put it: "The exciting thing is not financial, it's social—the phenomenon of a people's organization. This is a

[29] The title of "managing director" was soon changed to "president."

delightful place to be in an increasingly monolithic world."[30]

Chapter 4

Credit Unions Gain New Powers

Along with signing the legislation establishing the NCUA and share insurance in 1970, President Nixon ordered a study of the financial services industry. The Hunt Commission, so-called after its chairman, North Carolina Governor James Hunt, was told to find ways to make the financial system more efficient by unleashing competition.

The commission was asked "to move as far as possible toward freedom of financial markets and equip all institutions with the power necessary to compete in such markets."[31] The commission came up with 89 recommendations aimed at freeing financial institutions to compete with each other

The credit union movement was concerned that small credit unions would not be able to compete in a less regulated marketplace. Disunity among the Credit Union National Association (CUNA), the National Association of Federal Credit Unions (NAFCU), and NCUA, not to mention opposition of banking groups to giving credit unions any added powers, slowed progress toward legislation.

The movement eventually got its act together and presented a united front. After years of lobbying and legislative wrangling, the omnibus Financial Institutions Act was passed by Congress in 1977.

The act was weighted heavily toward expanding credit union powers to deal with the evolving marketplace. This demonstrated that credit unions had developed a significant voice in Washington, D.C. "Lobbies for banks and savings and loan associations must be feeling a bit like the tough kids who just found out the hard way that the new skinny kid on the

[30] "Credit Unions Still Growing," Wisconsin State Journal, January 18, Economic Review Section, 1976, p. 12.

[31] "The Report of the President's Commission on Financial Structure & Regulation," December, 1971, p. 9.

block has taken boxing lessons," an article in the American Banker commented.[32]

"If you are among the 32 million in this country who belong to a credit union, good news is on the way for you," announced consumer financial columnist Sylvia Porter. "Within days, legislation will be before President Carter to give credit unions the authority to offer you, a member, an array of additional services. This is the first major expansion of federal credit union powers since Congress passed the Federal Credit Union Act in 1934—over 40 years ago."[33]

New Lending Powers: While many state charters had the power to make home mortgage loans, federal credit unions had been limited to mortgages of only 10 years, which effectively shut them out of the market. The new law permitted federal charters to make mortgage loans of up to 30 years on principal residences. The law also permitted home improvement and mobile home loans of up to 15 years, instead of the previous 10 year limit.

To help credit unions get into the home loan business, CUNA Mutual joined with a subsidiary of CUNA Service Group to establish CUNA Mortgage Corporation in 1978. CUNA Mortgage bought mortgages from credit unions and resold them on the secondary market, thus freeing up their cash to make more loans. It also handled servicing of the loan for the credit union. By the end of 1979, CUNA Mortgage was servicing 25 loans worth $1.1 million, and would grow rapidly as home mortgage lending became a major business for many credit unions, especially larger ones.

Federal credit unions had been limited to unsecured consumer loans of up to $2,500, with a maximum maturity of five years. The legislation eliminated the loan amount limit, and extended allowable terms to 12 years.

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[32] Moody, J. Carroll and Gilbert C. Fite, *The Credit Union Movement:: Origins and Development, 1850 to 1980*, p 319.

[33] Porter, Sylvia, "Your Money's Worth," Nashua (New Hampshire) Telegraph, March 28, 1977.

Meanwhile, the rise of national credit bureaus during the 1970s—together with computerization of credit records—was making it easier and cheaper to evaluate the credit-worthiness of loan applicants. As already noted, one of the advantages of a tight common bond in credit union work was that loan committees and officers were familiar with the members of the credit union and able to evaluate their ability to repay a loan. Credit rating services made it less important for credit unions to have tight common bonds that provided intimate knowledge of the creditworthiness of members. As a result, the National Credit Union Administration (NCUA) could prudently relax field of membership (FOM) requirements somewhat, although nowhere near as much as it would in the early 1980s.

New Savings Instruments: To help credit unions compete for savings, the 1977 legislation permitted federal credit unions to offer share certificates similar to the certificates of deposit offered by banks and savings and loans. In exchange for a higher interest rate than permitted on regular share accounts, the member agreed to keep the money in the credit union for a fixed period of time, with a penalty for early withdrawal.

NCUA set the maximum rate for small share certificates at 8 percent. Large share certificates ($100,000 or more) could pay money market rates,

The credit union that neglected to offer certificates could find its members switching to institutions that did, Barbara Bean, President/CEO of Cal Poly Federal Credit Union, Pomona, California, recalled.

"I came into the movement in 1978 as an accounting clerk at what is now Orange County's credit union, with under $30 million in assets. One of my first duties was adding up all the checks that were written the day before. I can remember lots and lots of checks going to S & Ls—$30,000, $40,000, $50,000—lots of money back then. One day our CEO was in the accounting office and I asked him if we were going to get one of the new Certificate of Funds programs all the S&Ls had and where our money was going. He asked me 'what would we base our rate on?' I told him I didn't know—but, everyone else

was doing it (and) I was sure we could figure it out. He did not think so. We lost about 15 percent of our assets before the CEO was let go and a new CEO came in and soon thereafter we had a certificate product for our members."[34]

The percentage of deposits in federal credit unions invested in CDs skyrocketed as members chose certificates over passbook savings. Certificates, most of them tied to money market rates, made up 2 percent of savings accounts for federal credit unions in 1978. By 1980, they made up nearly a quarter of all deposits.

Between CDs and the new share draft (checking) accounts many larger credit unions were offering, the traditional passbook savings account was on the wane, sometimes becoming a vestigial account used to hold the $5-$25 initial deposit required for credit union membership.

The Credit Union National Association, its insurance affiliate CUNA Mutual, and the state leagues by 1970 were assisting credit unions in various ways to keep up to date. Subsidiaries owned by the two national organizations and the leagues provided credit unions with traveler's checks and money orders. In the early 1970s, these CUNA functions were brought under the umbrella of a holding company, CUNA Service Group (CSG), which would become an operating company in 1982 offering a wide range of products and services to credit unions through their state leagues.

In 1976, Jim Jukes, then president of the Kansas Credit Union League, accepted an invitation from CUNA to come to Madison, Wisconsin, and run the various CUNA Service Group programs being pioneered there, including an ATM project, credit card processing, and the checking program known as share drafts. "It was crazy," he remembered. "Everything was a challenge. We were always plowing new ground. They were great, wonderful, creative times."[35]

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[34] Bean, Barbara, E-mail to author, January 24, 2011.

[35]."Jukes reflects on nearly four decades of working with credit unions," Credit Union Times, January 5, 2000.

Chapter 5

The Electronic Age – Share Drafts, Other Products

Electronic technology was much on the minds of credit union leaders in the 1970s. The use of such technology in banking and business began in the 19th Century with the development of the telegraph, radio, and telephone. Posting and adding machines sped customer service in the 1940s and 1950s. Use of electronic technology accelerated through the 1960s and 1970s as computers moved from defense and space projects into the marketplace.

The first computers were large and expensive and needed skilled technicians to program and operate them. Only very large organizations like airlines and big banks could make use of them. But as the technology advanced, computers were shrinking to the size of a cabinet or desk and becoming much more powerful and less expensive. Employees accessed them through terminals equipped with keyboards and cathode ray tubes (CRTs, essentially small TV sets). The first rudimentary personal computers designed for individual users were coming on the market in the 1970s, but would not be a force in financial services until later.

By the later 1970s, most large credit unions relied on in-house or outside data processing to handle their accounting and print member statements.[36] Credit unions, like banking in general, were also became increasingly reliant on computers in other activities like lending, providing management with timely information, and providing service at a distance through electronic funds transfer (EFT).

EFT made use of networks of computers and telephone lines to transmit packets of information in digital form. These packets could range from e-mails to the information embedded on the magnetic strip on a credit card. The goal of government and financial institutions was to move away from "paper-

[36].“Improvement needed in management of National Credit Union Administration,” letter to NCUA Administrator Lawrence Connell from Washington Regional Office of General Accounting Office, June 19, 1978.

based" checks and currency and to bring about the more efficient, less expensive "checkless, cashless society."

In 1975, CUNA president Herb Wegner was appointed as representative of the credit union movement to a congressionally mandated Commission on Electronic Funds Transfer. He was named vice chairman, and became its de facto chair for an extended period when the commission's chairman became ill. Wegner's service gave him a bird's eye view of the commission's work and of EFT developments in general, and this helped the movement keep abreast of and guide this fast-evolving technology.

Electronic funds transfer could be divided into two major categories—wholesale EFT, which involved the dealings of financial institutions with each other, such as check clearing, and retail EFT, which included credit and debit cards, automated teller machines, and account access by touch-tone phone.

Share Drafts: The greatest challenge in the wholesale EFT area in the 1970s was modernizing the nation's check clearing system. Check clearing was the process by which banks presented checks deposited by their customers to the banks on which the checks were drawn, at the same time settling their accounts with each other. This was done through local clearinghouses among banks in the same city. But most "out-of-town" consumer checks were cleared and settled through the Federal Reserve's regional check processing system, which received checks deposited in banks, sorted them, shipped them interstate for delivery to the banks on which they were drawn, and then settled what each bank owed the others by means of their accounts at the Fed.

As the volume of checks being written soared into the billions, handling them became an increasing burden on the payments system, and intensive effort was going into automating the system as much as possible through the use of check sorting machinery and computers.

By 1970, these measures were making the clearing process more efficient. But the ultimate goal was to replace paper

checks with fully electronic transactions. The concept was first piloted through "automated clearing houses" (ACHs) early in the decade for certain pre-authorized payments and deposits. Although this effort was formalized with the creation of the National Automated Clearing House Association (NACHA) in 1974, it would take decades for the volume of electronic transactions to exceed the number of paper checks written each year by Americans.

Credit unions did not use the check clearing system until 1974, when, in a significant development, they began offering their members the use of "share drafts," the functional equivalent of checks. Most importantly, in terms of the advancement of EFT, credit unions did this by adopting a revolutionary method for check processing called "truncation."

Since the early 1960s, the clearing system had been able to handle checks on a fully automated basis by computer-reading the magnetic ink information printed along the bottom of each check (including the amount, which was added by the first bank of deposit). But banks were still stuck with the expensive task of physically sorting by customer the tens of thousands (or, for the large money-center banks, millions) of checks drawn on them that they received from the clearing system each month. Each paying bank had to store these tons of paper, bundled by customer, in bins and then mail them back to the customers who wrote them, along with their monthly statements.

Although everyone recognized this as fundamentally inefficient and hugely expensive, the conventional wisdom among bankers was that customers would rebel if they did not get their canceled checks back at the end of the month.[37]

However, the leadership of CUNA and CUNA Service Group saw a unique opportunity and believed that credit union members would embrace a checking-type account if it paid

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[37] This was despite its having been for many years the law in every state (and accepted by the IRS and other federal agencies) that a bank-provided photocopy of a canceled check was just as good as the original as proof of payment.

them interest (at a time when banks were prohibited by law from doing so)—even if they did not get their canceled checks back. In collaboration with Chase Manhattan Bank of New York, CUNA Service Group engineered a new method of handling consumer checking accounts that utilized Chase as a "payable through bank." CUNA's general counsel, Charles (Chuck) Seibold, navigated the complex legal issues related to the project and negotiated with the regulatory agencies.

Each of these new credit union share drafts prominently bore the name of the credit union on which it was drawn, but the payable through bank's name appeared in smaller type, and its routing number was printed in magnetic ink along the bottom of the draft, along with the draft's serial number, the member's account number, and a code that identified the credit union.

This meant, for example, that when a credit union member paid for groceries with a share draft anywhere in the country, and the grocery deposited the draft with its local bank, the clearing system automatically routed the physical share draft to Chase in New York. Chase then:

● determined through an electronic inquiry to the credit union or its data processor whether the share draft was good, and

● if it was, settled payment back through the payment system to the merchant's bank where it was first deposited, or

● if it was not, returned it as a Not Sufficient Funds (NSF) item back through the system.

Each day the credit union wired funds to Chase to reimburse Chase for the share drafts it paid for that day. The electronic "presentment" by Chase described above gave the credit union's data processing system all the information needed to post the share draft to the account of the member who wrote it.

Using automated equipment, Chase photocopied each paid draft as a record in case any questions arose but did not return the share draft to the credit union on which it was

drawn, and the member did not receive canceled drafts back with his or her monthly statement. Thus was the journey of the share draft "truncated." For the member's record, his or her share draft book was set up to make a carbonless copy of each draft as it was written.

Although Chase was a key partner in helping CUNA Service Group develop share drafts, in short order a number of other banks partnered with credit unions to offer payable through services. Later in the decade, U.S. Central Credit Union took on the task of handling net settlements between credit unions and the payable through banks. (By the mid-1980s, corporate credit unions would largely supplant Chase and other commercial banks as the primary providers of share draft processing services.)

Truncation cut by about half the cost of providing a checking account, and this meant that credit unions could offer the service on an interest-paying and, for many years, no-fee basis.

The key date for the start of share drafts was October 10, 1974, when the National Credit Union Administration (NCUA) accepted CUNA's proposal that share drafts be authorized on an experimental basis for federal charters, on the basis that this was permitted by the "incidental powers" clause of the Federal Credit Union Act.[38]

Almost immediately, state regulators started following suit, and by 1977, some 850 credit unions across the nation were offering share draft accounts to their members, who wrote some $1 billion worth of share drafts that year.

Although a number of commercial banks, like Chase, were profiting from this new credit union product, many bankers were outraged by what they believed to be an unlawful encroachment on their monopoly of offering checking accounts. Checking accounts (demand deposits) are a core product for

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[38] This clause granted federal credit unions authority to "exercise such incidental powers as shall be necessary or requisite to enable (FCUs) to carry on effectively the business for which (FCUs are) incorporated."

banks, and bankers did not appreciate a new competitor in this field.

As a result, banks in a number of states started leaning on merchants not to accept share drafts.[39] This was not reported in the credit union trade press since the Credit Union National Association did not want to trigger copycatting. Eventually, CUNA was able to deter this guerrilla war through legal pressure on individual banks and finally by getting the U.S. Justice Department to launch a formal investigation of the practice on the grounds of its being a violation of anti-trust law.[40] Bankers then turned to the courts to challenge the legality of share drafts. At the state level, court decisions went both ways on the question of whether state-chartered credit unions had the power under state law to offer share draft accounts. But the key case was filed against the National Credit Union Administration by the American Banker's Association in the Federal District Court for the District of Columbia.

CUNA and the National Association of Federal Credit Unions (NAFCU) entered the federal case as friends of the court on behalf of the agency. Credit unions won the first round when District Judge Aubrey Robinson ruled that NCUA was correct in determining that credit unions had the incidental power to provide members with share draft access to their funds.

But, in April 1979, the D.C. Circuit Court of Appeals ruled in favor of the banks, and the U.S. Supreme Court refused to consider NCUA's appeal. An estimated 338 million share drafts were written in 1979. If all of a sudden they could not clear any longer, you could imagine the havoc that would have been created in the marketplace, recalled Jim Barr, who was CUNA's new executive vice president in charge of legislative

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[39] A bank would tell merchants that if they accepted share drafts, the bank would only take them on deposit as special "collection items," for which a fee of $10 or more per draft would be charged.

[40] Swoboda, Ralph, conversation with author, May 15, 2012.

affairs.[41 42]

Apparently foreseeing just such a problem, the Court of Appeals stayed its judgment until January 1, 1980, so that Congress would have eight months to consider the issue and act. Subsequently, to give themselves still more time to consider the issue, lawmakers temporarily authorized share drafts from December of 1979 through March, 1980.

Meanwhile, CUNA launched an ambitious and, as will be recounted in Chapter 12, ultimately successful “Save Our Share Drafts”—S.O.S.—campaign to persuade Congress to authorize the new type of checking permanently.

Credit Cards: About half of American households had one or more credit cards in 1970, but most of these were issued by merchants and usable only at their establishments. A financial institution could issue its own card but this could be used only at merchants willing to accept that bank’s card. And it was expensive, more a convenience for better bank customers than a profit center—Citibank lost a billion dollars in its card venture.

As the decade progressed more and more households made use of “general purpose” cards that were accepted by a wide range of stores. Two bank consortiums—BankAmericard and Master Charge, known today as Visa and MasterCard—issued these. By offering Master Charge and/or BankAmericard cards, smaller financial insti-tutions could make them available to members.

In the early 1970s, CUNA began lobbying the two bankcard associations to accept credit unions as card-issuing members. Both organizations resisted but finally agreed. This set the stage for a 1977 agreement between CUNA Service Group and BankOne of Ohio to provide back-office credit card processing and technical support services that would allow credit unions to issue Visa credit cards. By the end of 1978, 100 credit

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[41] Some 70 percent of these were part of share draft programs supported by CUNA Service Group’s ICU Services Corporation.

[42] Barr, Jim, Interview, March 22, 2005, CUNA Information Resource Center Archive.

unions had adopted the CSG program, which later added support for credit union issuance of MasterCards as well.[43]

A Supreme Court decision in 1978 also helped to ensure that credit cards would become a major financial product for credit unions and banks.

Because of state laws restricting the interest card providers could charge, financial institutions had made little or no money on their credit cards. But in 1978, the U.S. Supreme Court ruled that the interest rate a card provider could charge was controlled by the state where the credit decision was made. States like South Dakota, with high or no usury limits, invited Citibank and other major banks to locate their credit card operations there. This enabled the credit card companies to raise interest rates on the cards, turning a loss leader into a profit center.

The resulting boom in credit card lending over the next three decades would make borrowing much more convenient for consumers, with all the benefits and evils freer credit would bring. Credit card lending and processing would become an important source of income for credit unions and their organizations and would supplant many of the traditional unsecured small loans credit unions had offered their members.

ATMs: Automated teller machines (ATMs) were another area of electronic funds transfer that grew during the 1970s. While the history of ATMs goes back to the 1960s and beyond, the modern ATM first appeared in the 1970s. ATMs could take deposits, transfer money from checking to savings or vice versa, provide cash advances from a credit card, and take payments.

The early ATMs were installed on the street side of bank premises to offer 24-hour service, which involved cutting a hole in the wall of the building. They were stocked with cash from inside the bank. Chase Manhattan Bank (now JP Morgan Chase) of New York held a public ceremony to publicize its first

[43] Moody, J. Carroll and Gilbert C. Fite, The Credit Union Movement: Origins and Development 1850 to 1980, Credit Union National Association, p. 294.

ATM. It was accessed by a card that had a daily dollar limit. The plan was for the bank's president, David Rockefeller, to withdraw cash in view of press and television cameras. As the hour of Rockefeller's appearance approached, a nervous public relations man tested the ATM card to be used by Rockefeller, withdrawing $15 and then another $15. Then he realized to his horror that he had reached the card's $30 limit on withdrawals. What to do? Rockefeller's limousine soon pulled up, the president accepted the ATM card and inserted it in the machine. The machine dispensed the money—but what Rockefeller and the press did not realize was that the bills were being doled out from inside the bank by an employee.[44]

It took people some time to get used to the new machines. Lewis E. Orr, vice president at Pittsburgh National Bank, recalled watching a woman who thought one of the bank's early ATMs was a postal box. She kept trying to push a letter into the slot. Each time, the machine rejected her letter a little worse for wear. Finally, she gave up.[45]

At first, ATMs were only accessible by special-purpose ATM cards, but late in the 1970s, debit or "check" cards were introduced, which could be used to withdraw cash from an ATM or could be used to pay for a purchase at a point-of-sale (POS) terminal in a store, although this function was slow to take off. The amount of the transaction would be withdrawn from the card user's checking account.

By June, 1975, the National Credit Union Administration had approved ATM installations at seven federal credit unions for use only by members. NCUA Administrator Herman Nickerson at that point authorized federal credit unions to install ATMs without NCUA approval.

NCUA also authorized Bolling Federal Credit Union and NCR Employees Credit Union to share ATMs. Meanwhile, banks were establishing and sharing local ATM networks, which would evolve into regional and national networks. An

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[44] This anecdote was told to Ralph Swoboda by Chase-Manhattan executives.

[45] "Pittsburghers Find Push-Button Banking Easy," Pittsburgh Press, June 27, 1982, p. 17.

ATM cost some $60,000 to install, which many credit unions could not afford, but NCUA authorized six federal credit unions to enter into an agreement with the United Bank of Arizona for members of the credit union to conduct business through the use of the bank's full-service ATMs. This became common practice for many credit unions.[46]

ATMs began coming into general use in the 1970s, and NCUA authorized them for federal credit unions. (Bigstock Photo)

ATMs would turn out to be a valuable tool in the credit union arsenal in the coming decade as field of membership requirements loosened and they were able to expand to serve more than one group. ATMs would help them reach members who might not have easy access to the main credit union office.

Telephone Access: Telephones were another way consumers could access their accounts, if only by dialing up the bank or credit union teller and asking for information or requesting a transfer of funds from one account to another.

If the financial institution had the proper hardware and software, consumers could access their accounts by dialing in or punching buttons to find out their account balances, switch money from one account to another, or pay bills. There were

[46] "Federal Credit Unions and Electronic Funds Transfer Systems," NCUA Pam-8501, April, 1976.

efforts to have home equipment with a video screen so consumers could actually see their accounts. These early systems were proprietary ones owned by the banks that developed them and met with little success because other financial institutions refused to buy them and they involved costs to the customer households. But better systems would make telephone access less expensive and easier to use, and thus increasingly common, in coming decades.

Chapter 6

Rise of the Corporate Credit Union System

As noted in Chapter 1, the principal challenge for U.S. credit unions in the post-World War II era was to accumulate enough savings to meet the demand for consumer loans. Ultimately, the problem was solved by the inflow of funds brought about by deposit insurance, new products like CDs and share drafts, and by eventual deregulation of consumer savings rates. But as the 1970s began, the credit union movement's first answer was to develop a system of "corporate credit unions" that could lend money to credit unions when they approached being "loaned out" of their own funds.

Many of these "corporates" began as state-chartered "central credit unions"—credit unions originally set up in various cities to meet the borrowing needs of credit union managers and board members who were restricted by law from borrowing at their own credit unions.

A number of these some 55 centrals were permitted by state law to serve employee groups too small to form their own credit unions. Over time, some also started serving small credit unions needing to borrow funds or deposit excess cash. The centrals reinvested members' funds in U.S. Treasury securities, savings and loans, and other investments. During the 1970s, the centrals started becoming more specialized, with some serving individuals only and others focusing instead on serving credit unions.

The second group became known as “corporate central credit unions.” The first “pure” corporate was chartered in Kansas. Jim Jukes, who was president of the league at the time, convinced the legislature to authorize a corporate credit union with broad enough powers to serve effectively as a “bankers' bank” for other credit unions. (In the movement's jargon, the latter are referred to as “natural person credit unions.”)

Initially, the corporates developed in an ad hoc fasion, but they became a national system with the founding of U.S. Central Credit Union in 1974 by CUNA. U.S. Central's membership was limited to corporate credit unions affiliated with CUNA's member leagues and to national credit union organizations, such as CUNA and CUNA Mutual. It was chartered in Kansas under the favorable law Jim Jukes had lobbied for, and it was initially managed under contract by the Kansas corporate. Its first full-time manager, Richard Ayhres located his office at CUNA headquarters in Madison, Wisconsin.

When U.S. Central started to outgrow its arrangements with Kansas Corporate, it added a few employees of its own in Madison. But the Wisconsin credit union regulator found out and objected to a “foreign” credit union operating in his state. When the regulator filed for a court injunction, U.S. Central staff packed a U-Haul trailer with all of the credit union's tangible assets (mostly files and a fax machine) and moved the already multi-million dollar “institution” back to Kansas, literally overnight. The staff set up headquarters in Overland Park, Kansas.

Even though it grew to over $30 billion in assets, U.S. Central never had more than a hundred or so employees. That was because its only function was to be a “corporate for corporates”—that is, a credit union that accepted and invested deposits from member corporates and provided correspondent banking services to them. U.S. Central, in turn, invested its deposits in U.S. government and agency securities, and in the obligations of very large money center banks.

Because of its conservative investment portfolio, U.S. Central could borrow at wholesale rates in the money markets to fund low-cost liquidity loans to its member corporates, who in turn could lend to their own member “natural person credit unions.”

In subsequent years, after it achieved the highest debt ratings possible, U.S. Central could borrow at the lowest interest rates available to anyone other than the federal government and its agencies. U.S. Central's short-term debt was rated A1+ and P1, the highest ratings available from Standard & Poors and Moody's respectively, and it later received AAA ratings for its long-term debt.

Corporate capital and U.S. Central’s capital came from retained earnings and, in later years, from special “paid-in capital shares” subscribed to by members. These membership shares earned a return but were at risk if the corporates got into financial trouble.

As we have noted, the early corporates and the fledgling U.S. Central were state chartered.[47] Most state corporates could serve a national field of membership but in practice most apart from U.S. Central served mainly credit unions in their home states. The first federally chartered corporate began its work in 1975. The federally chartered corporates at first were restricted to serving credit unions in their home states or regions, but by the 1990s would be permitted to serve national fields of membership. At their height, there were 46 corporates, but the number has shrunk substantially in recent decades due to competition and financial stresses.

The evolving corporate credit union system was not immune to the economic upheavals of the 1970s described later in this section. Several corporates were on the brink of failure during the decade due to the loss of value of the securities they held and had to be rescued with infusions of cash. Tennessee’s state-chartered corporate central hit severe financial problems late in 1979 and was rescued by the state’s banking department and a line of credit from U.S. Central

[47] U.S. Central eventually switched to a federal charter.

Credit Union. This was in accord with the traditional practice that where possible, the credit union movement would take care of its own.

The National Credit Union Share Insurance Fund (NCUSIF) had not been founded with corporates in mind, but since they were credit unions, corporates fell under its purview. Federal corporates were required to become insured, and state-chartered corporates, including U.S. Central, could and did become federally or privately insured.

This did not actually offer much protection to credit unions depositing funds with the corporates, since these deposits often greatly exceeded the insurance limits. However, by virtue of its legal powers to protect the fund from losses, NCUSIF would become the chief architect of the radical restructuring of the corporate system in the Great Recession of 2008-2009.

As the original main purpose of the corporate system, to provide liquidity in times of high loan demand, diminished in importance, the most significant roles of the corporate system would soon be to serve as a place to park excess liquidity and to provide financial services to member credit unions.

The credit union movement had long advocated for another source of borrowing, such as banks had in the Federal Reserve, and this came to pass in 1978 with congressional approval of a bill authorizing a Central Liquidity Facility (CLF) to be administered by NCUA. Credit unions could be members of the CLF directly or could access it through their corporate serving as an "agent member" of the facility. Members would subscribe to the capital stock of the CLF by contributing an amount equal to about ½ of one percent of their total member shares and capital. The CLF could borrow from the Treasury and issue bonds to raise money.

The Central Liquidity Facility turned out to be useful in certain cases but with liquidity less of a problem for the movement from the 1980s on, demand for its services would remain low for decades.

In view of the new credit union powers and competition from money market funds and other financial service

providers, major challenges lay ahead, noted author Donald J. Melvin and his associates in 1977, "challenges which could lead to continued vigorous growth in the industry if they are met successfully. But they could also produce equally negative results if the response of the credit unions is inadequate."[48]

Chapter 7

Low-Income Credit Unions

The 1970s were a key period for the small but vital category of credit unions dedicated to serving communities at the lower end of the economic scale. These credit unions have preserved much of the spirit and attitude of the early credit union movement.

While credit unions were organized in the 1920s, 30s, and 40s to serve poor rural farmers and other impoverished groups, the Johnson Administration in the 1960s saw credit unions as a tool in its Great Society program to fight poverty. With help from the Credit Union National Association and its member leagues, some 400 credit unions were organized through the federal Office of Economic Opportunity to serve low-income groups, usually in minority neighborhoods. They were often linked to local anti-poverty organizations known as Community Action Agencies. "But without sufficient resources, technical support, or realistic business plans, by 1970 many of these fledgling institutions had failed."[49]

While these OEO credit unions had fought to be covered by the new federal share insurance, they found it a two-edged sword. Not every credit union serving the poor could qualify. Many of those that survived into the 1970s were still working under marginal conditions. Advocates protested that NCUA was too harsh in its handling of these small, struggling credit unions, and that with more patience and assistance some

[48] Melvin, Donald J., Raymond N. Davis and Gerald C. Fischer, *Credit Unions and the Credit Union Industry*, Temple University, New York Institute of Finance, 1977, p. 193.

[49] "Our History," National Federation of Community Development Credit Unions, www.natfed.org.

could have succeeded. But early action by NCUA in closing weak credit unions may have avoided larger problems down the line. Delays by regulators and Congress in dealing with troubled banks and savings and loans were later blamed for some of the large losses suffered by these institutions and the taxpayers.

To defend their interests, the anti-poverty credit unions in 1974 organized their own association, the Federation of Limited-Income Credit Unions, soon renamed the National Federation of Community Development Credit Unions (NFCDCU) to better express the federation's goals.

It should be noted that while many anti-poverty credit unions serve a largely minority membership, not all minority credit unions serve the poor or think of themselves as community development institutions.

A typical NFCDCU member was Bethex Federal Credit Union in the Bronx, founded in 1970.

Bethex was organized by Joy Cousminer, together with the "welfare mothers" who comprised her Adult Basic Education Class. As of this writing (2012), she remains the president of the credit union.

"Joyce Cousminer founded Bethex Federal Credit Union in 1970. (New York State Senate Photo)

In the beginning, before the days of seed money and grants, the credit union was operated by volunteers, as the founding members saved their nickels and dimes in true grass

roots fashion. Once they had sufficient capital they began to make small loans. Sometimes there was not enough money to meet the borrowers' needs, and a waiting list was set up. The returns were invested in the membership and the community again and again over the years . . . ," according to the credit union's web site.[50]

Bethex carried on a precarious existence for the next two decades, moving so many times it was jokingly referred to as the "gypsy credit union." But it survived and as of this writing had some 9,000 members served by two branches and $16 million in assets.

CDCUs were increasingly needed as the economic turmoil and market competition of the 1970s caused larger banks to focus on cutting costs and serving their best customers. This led to closing bank branches, especially in low-income areas. It also increased "red-lining," the refusal to lend in low-income, usually minority neighborhoods.

In response to such practices, community advocates were able to win passage in 1975 of the Federal Home Mortgage Loan Disclosure Act (FHMLDA) and the 1977 Community Reinvestment Act (CRA). These acts required financial institutions to keep records of their loan decisions and invest funds back into the areas where they obtain funds in the form of deposits.

Credit unions were exempted from the Community Reinvestment Act, on the grounds that they were not causing the problems, but the National Federation of Community Development Credit Unions has used CRA creatively to obtain bank assistance of various kinds for low-income credit unions, plus tapping many other forms of governmental and non-profit aid.

The Federation spent much of the 1970s lobbying for federal funds to support the work of low-income credit unions. In 1977, it won a small grant from the Carter administration that enabled it to hire its first paid director, Jim Clark. In 1978, the Federation persuaded the National Credit Union

[50] "About Us," Bethex Federal Credit Union, www.Bethex.org.

Administration to create a special category of "low-income" credit unions that would allow certain credit unions to accept deposits from outside their membership—interest-free money that could be used to increase their capital.

In 1979, Congress authorized the Community Development Revolving Loan Program (CDRLP) funded by $6 million to be administered by the NCUA and the successor agency to the Office of Economic Opportunity, the Community Services Administration. "However, this was only an ephemeral victory for CDCUs," write Lune and Martinez, "since the low-income designation was notoriously difficult to obtain, and the NCUA revolving loan fund made almost no loans for over 10 years."[51]

This history will continue to follow the fortunes of the Federation and its members through the following decades.

Chapter 8

Black and Feminist Credit Unions

As noted, many community development credit unions were located in minority neighborhoods. Apart from low-income credit unions per se, ethnic groups, such as Jews, Catholics, Polish-Americans, Asian-Americans, and African-Americans often saw credit unions as a way to boost themselves by their bootstraps into the mainstream of American life. This chapter looks at black credit unions and then, feminist credit unions.

As the 1970s opened, whatever tranquility Americans had experienced in the post-World War II era had faded. The African-American civil rights struggle had begun in the 1950s and flared in the 1960s to win historic gains for blacks. Inspired by this example, American women began agitating for fairer treatment in all aspects of life. Credit unions had a role

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[51] Lune, Howard and Miranda Martinez, "Old Structures, New Relations: How Community Development Credit Unions Define Organizational Boundaries," Sociological Forum, Vol. 14, No. 4, 1999, p. 621. NCUA by the end of the period covered by this book was enthusiastically encouraging credit unions to take on low-income status.

in all this, although the movement as a whole encompassed a variety of attitudes toward social change.

African-Americans had long looked to cooperation to ameliorate the effects of slavery and economic deprivation. In the 19th and early 20th centuries, they founded cooperatives of many different types, including credit cooperatives. Black credit unions were established from the 1920s onwards to help poor farmers and urban groups move toward economic self-sufficiency.

Black-owned businesses formed credit unions, as did churches and other organizations. According to the Negro Year Book, in 1951 there were at least 102 credit unions in 26 states operated by blacks.[52] They included Tuskegee Institute FCU in Alabama, First A.M.E. Church FCU, Los Angeles, and Sacramento NAACP Credit Union, Florida. Martin Luther King and the Montgomery (Alabama) Improvement Association sought a federal charter for a credit union, but were turned down on the grounds that the association was too broad a field of membership. (As we have noted, the field of membership requirements were very tight at that point.)

NCUA did not collect information on the ethnic character of credit unions, but in the spring of 1980, federal supervisory examiners conducted a survey to identify black credit unions. The survey yielded a sample of 547 established black-controlled credit unions that researchers Harold A. Black and Robert L. Schweitzer studied. "Black-controlled" meant more than half the board members and membership was black.

The average asset size of the black-controlled credit unions was $1,720,000, compared to $3,514,000 for all federally insured credit unions. About half of the credit unions (270) had an occupational bond, 245 had associational bonds (such as church sponsorship), and 32 had residential common bonds.

Black and Schweitzer found that black-controlled credit unions tended to be more profitable than other types of black-

[52] Guzman, Jesse Parkhurst, Editor, "A Review of Events affecting Negro Life," *Negro Year Book*, Tuskegee Institution, 1952, p. 137.

controlled financial institutions. They suggested that this might be due to member control. “As a result, credit union members have a more direct interest in the well-being of the institution.”[53] They noted that, “Participation and ownership are especially important in the black community where the clientele of these credit unions have been historically disenfranchised from financial institution ownership and participation.”

In another analysis, the researchers compared these credit unions with peer non-black credit unions of the same asset size and field of membership to try to find out how they differed. In general, the black-controlled credit unions had 71 percent of their assets out in loans, compared to 84 per cent for the non-black credit unions. Black-controlled credit unions also held a larger loan-loss allowance. The researchers concluded that this indicated that the black-controlled credit unions had fewer good lending opportunities due to the lower economic status of their membership. As we might guess, the most favorable lending and loss performance occurred among black credit unions with an occupational bond, reflecting the more stable income of their members.[54]

Although African-Americans have belonged to credit unions roughly in proportion to their share of the general population, the organized movement has had an “embarrassing lack of diversity in CU leadership in the U.S., especially African-American representation,” Frank Diekmann of the Credit Union Journal has noted.[55]

Pete Crear was the highest-serving black credit unionist in the U.S. movement in the period covered by this history. He

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[53] Black, Harold A. and Robert L. Schweitzer, “The Effect of Common Bond on Credit Union Performance: The Case of Black-Controlled Credit Unions,” The Review of Black Political Economy, Spring, 1987, 89-98. (Black served on the NCUA board 1979-81.)

[54] Black, Harold A. and Robert L. Schweitzer, “Black-Controlled Credit Unions: A Comparative Analysis,” The Journal of Financial Research, Vol. VIII, No. 3, Fall, 1985, 193-202.

[55] Diekmann, Frank, “Leaving the World (Council) a better place,” Credit Union Journal, May 16, 2011, p. 6.

rose from a field representative with the Michigan League to head the Connecticut and then the Indiana Credit Union League and eventually to serve as chief operating office of CUNA and then president and CEO of the World Council of Credit Unions.

Crear found his first job with the Michigan League after graduating from college with an accounting degree. The job opportunities for a white-collar African-American in racially tense Detroit at that time were few and far between. But the league was hiring management trainees for several new programs and gave him a job. The league and its affiliates already had African-Americans on staff but in lower-level positions. He felt welcomed. Among his other skills, the league found him valuable in organizing and working with credit unions in the inner city with its predominantly black population. Through the years, his talents and warm personality enabled him to rise high in the movement.

Crear once told the author that when "you rise high enough in the movement, the scenery is awfully white." The reasons for lack of black and other minority faces at upper levels in movement organizations are probably many but to the author's knowledge have not been thoroughly researched.

Credit union organizations have tried to attract minorities into the field with internships and other programs. One of the organizations active in this area is the African American Credit Union Coalition, founded in 1999 as a result of social gatherings at CUNA annual governmental affairs conferences. By 2012, its membership included 150 credit unions, five leagues, and more than 400 credit union officials and volunteers. The group offers internships, scholarships, and other incentives to attract young blacks to the movement.

The federal Equal Employment Opportunities Commission collects annual statistics on minorities in:

- all private businesses covered by Title VII of the Civil Rights Act of 1964 and having more than 100 employees

- and all employers with 50 or more employees holding contracts of $50,000 or more with the federal government.

Those statistics reveal that credit unions in these categories employed 73,032 individuals in 2010, compared with 890,204 in commercial banking.

African-Americans made up 10.5 percent of the credit union workforce, compared to 13.4 percent of commercial banking employees. They made up 3.5 percent of credit union executive/senior level officials and managers and 7.8 percent of first/mid level officials and managers. This compared with 2.5 percent and 7.3 percent in commercial banking.[56]

The women's liberation movement was in full swing by the 1970s as women sought equal treatment in marriage, education, sports, and the workplace.

In the area of financial services, women were subject to discrimination and condescension. They found that to obtain a loan, they had to get the signature of their husband, or if they were single, the signature of a male relative. They were often asked personal questions, such as "Yes, you're working, but what if you get pregnant? How will you repay your loan?"

Frustrated and angered by this kind of treatment, some women looked to cooperative credit as an answer. Some credit unions already catered to women and their families, and many smaller credit unions were headed by women, were staffed largely by women, and served many women members, but they were not organized specifically by women for women.

In 1973, a group of Detroit women led by Joanne Parrent and her partner Valerie Angers telephoned the Michigan Credit Union League with a proposal to start a credit union. It would be open to "anyone who has the goal of working for the improvement of the condition of women."[57]

"The first man we talked to didn't even know what a

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[56] Equal Employment Opportunity Commission, "2010 Job Patterns for Minorities and Women in Private Industry (EEO-1): 2010 EEO-1 National Aggregate Report by NAICS-5 Code," 52213: Credit Unions and 52211: Commercial Banking.

[57] Enke, Anne, *Finding the Movement: Sexuality, Contested Space, and Feminist Activism*, Duke University Press, 2007, p. 202.

feminist was," Angers remembered.[58] They were told that the proposed field of membership was much too broad to fit NCUA requirements. "We needed a common bond—area, association or employment—and decided that our common bond would be feminist groups," according to Angers.[59] So they narrowed their field of membership to members of several feminist groups, including the local chapter of the National Organization for Women (NOW), which had been founded in 1966.

Shortly after, Angers and Parrent led a group of some half dozen women to visit league headquarters in Southfield. Pete Crear, by then an experienced credit union organizer, was assigned to work with the women. Crear gave the women the usual advice about starting a credit union—that it was a lot of work, that you had to follow rules, that you had to have someone who could do accounting, and the like. "And they seemed to be pretty much ready for it," Crear recalled.[60]

The women were far from passive recipients of the advice. "They tested everything we said," according to Crear, including field of membership requirements. But they finally accepted that NCUA requirements needed to be met, and applied for a charter, which was quickly granted.

In August, 1973, the nation's first avowedly feminist credit union, appropriately named Feminist Federal Credit Union, opened its doors in Detroit on the 53rd anniversary of women's suffrage. Men could become eligible for membership by joining one of the organizations comprising the common bond of the credit union.

The fledgling credit union initially shared a building with the Feminist Health Center on the boundary between Detroit and its northern suburbs. One of the two front rooms was used by the health center and the other by the credit union.

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[58] "Women cash in as credit equals," Independent (AM) and Press Telegram (PM), Life Style, Long Beach, California, July 1, 1975, p.B-8.

[59] "They're giving the women credit," Oakland Tribune Woman Today Section, June 12, 1975, p. 49. This was an era when women's pages still existed.

[60] Crear, Pete, Interview, September 21, 2011.

Parrent and Angers lived in the back of the building. The health center provided a range of services to women, including early-stage abortions. Angers and Parrent worked in the credit union, but also assisted in the health center.

Bankers visited the new credit union to discuss how to lend to women. The bankers in their suits would talk with the two women in their flannel shirts and boots. Midway, Angers might be called away to the health center to assist in an early-stage abortion (as an artist she had steady hands) and then return to continue the discussion with the bankers.[61]

The credit union's founders continued to challenge the league, submitting a series of resolutions at league annual meetings that sparked debate on such topics as changing league bylaws to use gender-neutral language. Some of these resolutions were approved, although the feminists' militant approach irritated some league members.

The founders and their associates in the women's movement envisioned a far-flung network of credit unions extending loans for women's needs. In 1974, Women's Southwest FCU in Dallas became the nation's second feminist credit cooperative. Others sprang up around the country over the next few years. In 1975, women representing feminist credit unions and enterprises met in Detroit to form the Feminist Economic Alliance (FEA) to bring "economic independence, power, and self-help to every woman in America."[62]

The women's movement and its allies succeeded in persuading Congress to pass the Equal Credit Opportunity Act (ECOA) in October, 1975. While it was phased in over a two-year period, the feminist credit unions helped to educate their members about the provisions of the act and what it meant for women.

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[61] Enke, Anne, *Finding the Movement: Sexuality, Contested Space, and Feminist Activism*, Duke University Press, 2007, p. 204. 33 "Feminist Economic Alliance Formed to Aid New Sister Credit Unions,"

[62] Feminist Economic Alliance press release, December 9, 1975, Special Collections Library, Duke University.

While the act certainly did not correct all the problems women faced in obtaining credit, over time the law and changing attitudes diminished the need for financial institutions aimed specifically at women. More than 22 feminist credit unions were organized, but they suffered from many of the disabilities other small credit unions experienced —largely volunteer staffs, a limited membership base, and difficulty in accumulating enough assets to provide a full range of services.

One by one the feminist credit unions were liquidated or they merged with other credit unions. As of this writing (2012), Women's Southwest Federal Credit Union, now located in San Diego, is the only feminist credit union remaining in the U.S. It has about 800 members and $2 million in assets.

The shifting attitudes of the 1960s and 1970s were also felt within the broader credit union movement. A majority of credit union employees were women and some 34 percent served as managers. This was a much greater proportion of female managers than was found in the banking and thrift industries, but most women managers were employed among the smaller credit unions.

In 1971, at a session of CUNA's summer school at the University of Wisconsin-Madison, Wisconsin, a group of women met informally to discuss the status of women in the movement. They considered the fact that older white men dominated most credit union boards. This extended to the boards and leadership of state credit union leagues and the Credit Union National Association itself.

Louise Herring, the Ohio credit union pioneer who had helped organize some 500 credit unions over a half-century, argued that "elderly, affluent white males" controlled the movement. She said, "we have to fight lip service given to minority groups. Those in charge do not really want women, blacks, youth and other minorities involved because the boards do not want to give up their positions of power."[63]

[63] Moody, J. Carroll and Gilbert C. Fite, *The Credit Union Movement: Origins and Development 1850 to 1980*, p. 273.

Out of this discussion, in 1972, sprang the CUNA-affiliated Association of Credit Union Women whose purpose was to "educate, promote and enlighten women so they might better serve the credit union movement in the world."

Like the feminist credit unions, the association did not prosper over the long run. Other local or regional organizations have sprung up from time to time dedicated to promoting women in the movement. No prominent national organization exists as of this writing, although a group in Missouri organized the Women's Association of Credit Union Leaders (WACUL) in 2009 with 40 members from Missouri and Kansas.

Founder Lisa Ginter, chief operating officer of Community America FCU, Kansas City, Missouri, stated in 2011 that "we will be starting up membership chapters in other states to support the networking opportunities."

The purpose of WACUL is to "help increase the number of women in leadership roles," Ginter said. "While credit unions have many women in manager roles, it drops off dramatically in the larger credit unions . . . . (WACUL) is not a 'club' intended to be divisive toward men . . . . WACUL helps women feel they have a seat at the table."[64]

The World Council of Credit Unions sponsors a Global Women's Leadership Network (GWLN) which seeks to connect credit union women around the world, but it is too early to tell what success it will have.

If we look at Equal Employment Opportunity Commission statistics for 2010, women comprised 71 percent of employees in the credit unions covered by its survey. This compared to 59.5 percent in commercial banking. Some 41.6 percent of executive/senior level officials and managers were women, compared to 29.6 percent in commercial banking. Some 64.7 percent of first/mid level officials and managers in credit unions were females compared to 49.2 percent in commercial banking. Because smaller credit unions were not included in

[64] Ginter, Lisa, E-mail to author, November 23, 2011.

the survey, it is likely that these figures understate the role of women in credit unions. [65]

Chapter 9

Economic Turmoil

As the 1970s opened, protests over the Vietnam War were adding to the social upheaval stirred by the black civil rights and women's liberation movements. At the same time, the nation's domination of the world economy was slipping as Europe and Asia recovered after the destruction of World War II. Protected by the "Pax Americana," Western European countries and Japan rebuilt their devastated economies, investing in new factories and innovative products and manufacturing techniques.

Meanwhile, many American industries were saddled with aging plants and inflexible management and work rules. Competition from abroad and from the newly air-conditioned, lower-wage southern "Sun Belt" states was turning the manufacturing heart of the nation, the area around the Great Lakes, into the "Rust Belt" as older manufacturing plants shut down. The steel, automotive and electronics industries were hardest hit, as were their credit unions.

The economy's structure was shifting in other ways as well. Ever since the end of World War II, the share of employment in manufacturing had been declining, and the 1970s would see that trend accelerate. Meanwhile, the service economy was growing and by the early 1980s would employ more than half of the nation's workforce.

The U.S. had been exporter to the world. By 1970, the trade balance had tipped the other way as Americans bought more goods from abroad than they sold. The U.S. experienced

[65] Equal Employment Opportunity Commission, "2010 Job Patterns for Minorities and Women in Private Industry (EEO-1): 2010 EEO-1 National Aggregate Report by NAICS-5 Code," 52213: Credit Unions and 52211: Commercial Banking.

sluggish growth and accelerating inflation, a phenomenon economists dubbed “stagflation.”

The inflationary trend had started back in the mid-1960s, when the annual inflation rate was a modest one percent. While economists disagree over the root causes of the prolonged inflation, many think the immediate trigger was President Lyndon Johnson’s policy of pursuing war in Vietnam without sacrificing his Great Society anti-poverty programs or raising taxes, a policy often described as “guns and butter.”

By the late 1960s, alarmed at the decline in value of the dollars they were accumulating as a result of their sales to the U.S., foreign countries were using them to buy gold from the U.S. government’s stockpile at $35 an ounce. By the time Johnson’s GOP successor, Richard Nixon, entered office in 1969, there was a “run” on U.S. gold that was depleting our reserves of the precious metal.

Nixon came into office hoping to moderate if not drastically lower the inflation rate. His “game plan” sought to slow demand by cutting government spending and counting on Federal Reserve monetary policy to reduce growth of the money supply.

The cost was a recession starting in December of 1969 and extending into 1970 that did moderate inflation, but led to unemployment shooting upward. It continued rising even after the recession formally ended.

Consumer financial columnist Sylvia Porter noted late in 1970: “A nightmare combination of climbing unemployment, still sharply rising prices, sluggish business activity, fading profits, spreading bankruptcies and Wall Street disasters is hardly a successful game plan!”[66]

As seen earlier, most credit unions were in a strong position, with their main problem being a shortage of liquidity —that is, easily available funds to lend. Credit unions overall had nearly 95 percent of their savings deposits loaned out, the

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[66] Porter, Sylvia, “Your Money’s Worth,” News-Paradigm, Benton Harbor, Michigan, December 1, 1970, p. 22.

highest level in American credit union history.

What were credit union members buying with the help of their loans? Purchases included durable goods like new and used automobiles (29 percent of all lending), household goods, boats, and mobile homes. After durable goods, the next largest single category was debt consolidation (15 percent), followed by a miscellany consisting of loans for things like medical treatments and vacations.

As the recession progressed, loan demand slowed, while credit union savings inflows increased, thanks in part to the new federal share insurance program and the tendency of consumers to save more in recessionary times. Federal credit union savings jumped 20.5 percent in 1971, the largest percentage jump since 1955. By yearend 1971, the loan to savings ratio had declined to 88 percent.

The public, though concerned about inflation, was much more worried about unemployment, and the Administration saw that it faced losing the 1972 presidential election unless it changed course. After much discussion, the Nixon team decided that it would follow an expansionary policy to increase employment, and try to control inflation through a mechanism that Nixon himself had long considered bad economics.

On a Sunday evening, August 15, 1971, President Nixon went on television and radio to announce what he called a New Economic Policy. This included ending the run on the nation's gold reserves by closing the "gold window," i.e., no longer exchanging gold for foreign-held dollars. To give American industry some relief from foreign competition, he imposed a 10 percent surtax on foreign goods entering the U.S.[67]

But the words that most caught the public's imagination and initial approval were these: "I am today ordering a freeze on all prices and wages throughout the United States for 90 days." (Congress had given presidents this power without much expectation they would ever use it.)

[67] This was soon discontinued after being found illegal.

Raw agricultural products were the only exception to the freeze. Treasury Secretary John Connally explained it this way to Virginia Knauer, the president's consumer adviser: "Remember, Virginia, when it's a cucumber you can raise the price, but when it becomes a pickle, it's frozen."[68]

The three-month freeze was designed to hold the line on prices while the Federal Reserve increased the money supply to stimulate the economy. This Phase I was followed by Phase II, more flexible control of wages and prices by a Pay Board and a Price Commission, which in turn was followed by Phase III, voluntary compliance with wage and price goals. It was hoped that these progressively relaxed controls, known as an "incomes policy" in the jargon of economists, would reduce inflationary expectations on the part of labor and business and result in steady growth with little inflation.

Together with the effects of the recession, the program worked temporarily, with the rise in the consumer price index dropping from 5.6 percent in 1970 to 3.3 percent by the end of 1972. Meanwhile, the economy expanded strongly. Although the demand for loans increased, credit unions continued to see even stronger inflows of savings as their share insurance kicked in, so their loan to savings ratio dropped still further to 86 percent by yearend 1972.

Nixon won reelection. The economy did well for two more years. But the incomes policy ultimately proved to be a failure. The world oil surplus that had kept fuel prices low for two decades had disappeared, and the Organization of Petroleum Exporting Nations, OPEC, began raising its per barrel price. Prices for home heating oil and gasoline shot up, while food prices rose rapidly as well. The remaining controls could not contain the inflationary pressures, with consumer prices rising 8.7 percent in 1973.

With brisk demand for credit and rising inflation, the Federal Reserve used its powers to tighten the supply of credit, with the result that general interest rates began to climb. This

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[68] Walker, William N., "Forty Years After the Freeze," web-published reminiscence, 2011, p. 3.

slowed loan demand, but as a result, large credit unions began to experience some disintermediation—members withdrawing funds to seek higher rates elsewhere, especially in an attractive new vehicle, money market funds.

Law and regulation set the rates paid on passbook accounts. Under the Federal Reserve's Regulation Q, banks were limited to paying no more than 5 percent on passbook savings, while savings and loans were allowed a slightly higher limit of 5.25 percent to ensure they would have enough money to keep making mortgages

Federal credit unions were not covered by Regulation Q but were limited by the Federal Credit Union Act to a 7 percent ceiling. The exact rate was set by NCUA. In the early 1970s, the ceiling for federal credit unions was 6 percent.

The higher limit on credit union passbook savings interest gave credit unions something of an edge in attracting deposits. But inflation was nibbling at the value of member savings. Even if you earned 6 percent on your passbook savings, when inflation was reaching toward 11 percent, your savings were actually falling in value. Your natural tendency was to look around for a better return on your savings—and millions of Americans were doing just that. They were discovering money market mutual funds.

The money market funds were part of a network of suppliers of credit and savings instruments springing up outside the traditional banking system. This "shadow banking system," as it is now often called, would grow over the decades to rival the banking system itself in assets, and its growth would soon force the restructuring of the American banking system.

Firms like Merrill Lynch, Fidelity, and Vanguard offered money market mutual funds, which channeled consumer and business savings into short-term, very safe—though uninsured—Treasury bills and commercial paper—i.e., debt obligations.

By giving savers a way to access higher interest rates, money market funds won an increasing share of the savings market.

Columnist Sylvia Porter noted: "A fantastic $1 billion or even more has been poured by an ever-mounting number of small investors from coast to coast into the so-called money market funds in the past year (1973) alone. While mutual funds which invest primarily in stocks have been fading fast, these new cash haven funds have grown from a standing start a mere year ago to at least 20 separate funds today—and new money market funds are springing up every other week."[69]

The Federal Reserve came to the rescue of the banks and thrifts by relaxing Regulation Q restrictions on longer-term certificates of deposit so they could offer money market rates and effectively compete for savings. Credit unions did not yet offer CDs, but NCUA tried to help federal credit unions by raising the interest rate it allowed on passbook savings from 6 percent to its legal maximum of 7 percent.

As a result of disintermediation, larger credit unions began trimming expenses, restricting certain types of loans, and borrowing by issuing "certificates of indebtedness" to members and others.

President Nixon was increasingly mired in the Watergate investigation of his administration. And then, in response to American support for Israel in the 1973 Yom Kippur War, the Arab oil nations in October of that year embargoed oil shipments to the U.S. and Western Europe.

Between the embargo, rising oil prices, and a stock market crash, the economy plunged into a severe recession. The Gross National Product declined 2.2 percent in 1974 after increasing 6.5 percent in 1973. Unemployment jumped from 4.9 percent in 1973 to 7.2 percent in 1974. Despite the economic slowdown, the consumer price index soared by 12.3 percent.

"The pocket electronic calculator remains a hot item for retailers," dryly noted the Associated Press in 1974, ". . . probably because it makes it possible to determine where you are in relation to inflation."[70]

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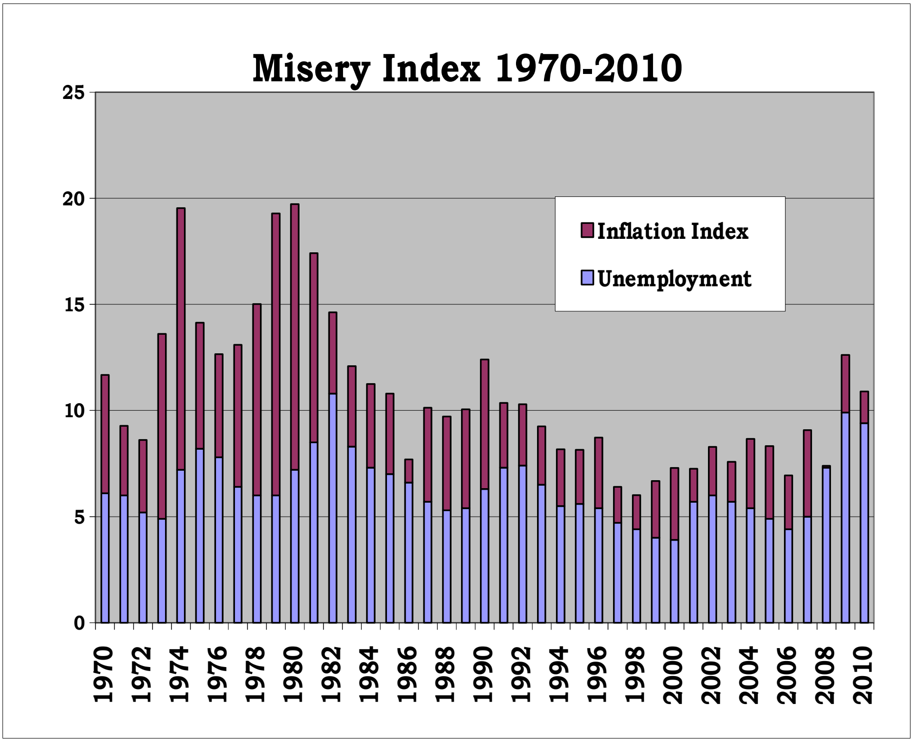
[69] Porter, Sylvia, "Your Money's Worth," Abilene (Texas) Reporter-News, September 4, 1974, p. 7-C.



The Misery Index was a Jimmy Carter campaign gimmick than contributed to President Ford's reelection defeat.

President Nixon resigned in August, 1974, as he faced an impeachment trial over the Watergate scandal, and Vice President Gerald Ford succeeded him. Ford tried a voluntary anti-inflation drive, called Whip Inflation Now (WIN), complete with WIN lapel buttons, but it didn't work. People derisively wore the buttons upside down to spell NIM—No Instant Miracles. The recession deepened in early 1975. Unemployment rose to 8.2 percent.

The economy rebounded over the next two years, as did credit union growth. In 1976, the American bicentennial year, Ford sought to win reelection for a full term. His Democratic

[70] "Calculators print out inflation shock," Associated Press, The Lima (Ohio) News, November 10, 1974.

opponent, former Georgia Governor Jimmy Carter, campaigned citing a measure called the "Misery Index" originated by economist Arthur Okun. The measure combined the inflation rate of 4.9 percent and the unemployment rate of 7.8 percent into a "Misery Index" of 12.7. Carter won, but his policies were not able to deal with inflation either, and the Misery Index soon rose to nearly 20, a record not equaled since then.

Credit unions, like other depository institutions, get most of their income from the "spread" or margin between what they pay depositors in dividends (interest) and the interest they charge borrowers for the use of depositors' funds. The top interest rate federal credit unions could legally charge at this time was 12 percent. With a savings rate of 7 percent this gave a spread of 5 percentage points, or 500 basis points in credit union terminology, which went to pay expenses and add to reserves.

The new credit union products like share certificates and interest-bearing share drafts, together with the impulse of consumers to save more, led to credit union deposits' increasing by three and a half times during the 1970s. But lending did not always keep up with the deposit growth, and this depressed earnings (loans are the most profitable way credit unions can use their money). In addition, credit unions faced increased expenses due to the switch to certificates of deposit that was forcing credit unions to pay more for their money, together with added administrative expenses from the new products coming on line, like share drafts and credit cards. These added expenses narrowed the spread between credit unions' cost of funds and income from loans made at rates bumping up against the 12 percent ceiling.

This narrowing spread, together with lower loan growth in some years, made it difficult to maintain the ratio of capital to assets credit unions had enjoyed in the late 1960s. The ratio sank from 6.3 percent of assets in 1970 to 4.6 percent in 1979.

The new Federal credit union deposit insurance also may have been a factor in declining capital to asset ratios, according to economists Harold Black and Robert Dugger, who

argued that credit unions felt that with insurance protecting member deposits, they could safely reduce their capital and level of liquidity, i.e., the amount of easily available cash on hand.[71]

Capital would begin growing again in the 1980s in response to regulatory and economic changes and would continue climbing through most of the period covered in this book.

Chapter 10

Volcker Fights Inflation

During the 1970s, "large price increases were the norm, like a rain that never stopped," writes Robert J. Samuelson. "Sometimes it was a pitter-patter, sometimes a downpour. But it was almost always raining. From week to week people couldn't know the cost of their groceries, utility bills, appliances, dry cleaning, toothpaste and pizza."[72]

"It was the biggest inflation and the most sustained inflation that the United States had ever had. We had had brief periods of inflation, but this had built up over more than a decade rather continuously. It was getting worse, rather than getting better," recalled former Federal Reserve Chairman Paul Volcker many years later.[73]

Throughout the economic ups and downs, most credit unions remained strong, though increasingly buffeted by the effects of inflation on interest rates.

Inflation began to soar again in the late 1970s, to 9 percent in 1978 and nearly 13 percent in 1979. As interest rates on Treasury notes and other money market investments soared,

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[71] Black, Harold A. and Robert H. Dugger, "Credit Union Structure, Growth, and Regulatory Problems," 1981, The Journal of Finance, Volume 36, Number 2, May 1981, pp. 529-538.

[72] Samuelson, Robert J., *The Great Inflation*, Random House, New York, 2008, p. 5.

[73] Volcker, Paul, Interviewed on the PBS program series, "The First Measured Century," in 2001.

money market fund growth exploded. The funds ballooned from $1 billion in assets in 1973 to $74.5 billion by 1980 and $235 billion by 1982.[74]

Credit unions and other depositories had to work hard to lure and retain savers. In 1979, savings growth slowed while loan demand continued strong as consumers sought to maintain their standard of living.

The relatively low 12 percent interest which federal and many state credit unions were permitted to charge on loans encouraged member borrowing. But the diversion of consumer savings into money market mutual funds hampered the ability of credit unions to lend. The loan to share ratio rose to nearly 90 percent. The shortage of cash to lend was leading many credit unions to limit lending or halt it altogether.

"I recall being 17 in the late 70's and just starting my job in CU land," Heather Harris, vice president of community development/marketing at Isabella Com-munity Credit Union in Mt. Pleasant, Michigan, told the author.[75] "We were close to 100% loaned out . . . and I was in charge of 'scheduling' the loan closings. We could only do a certain dollar amount each day . . . and were booked out over two weeks in advance. Members didn't mind, they just waited. I was never told why (the loans were delayed)—and years later learned the reality of the situation when I learned about 'being loaned out.' Today, we struggle to get over 70 percent loaned out, and can't imagine those days."

Credit unions began losing borrowers to finance companies, even though the finance companies charged higher loan rates.

Together with social and political disruptions and foreign policy setbacks, inflation was undermining national confidence. On July 15, 1979, President Carter gave his now-

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[74] These funds should not be confused with money market accounts offered by depository institutions after Congress in response authorized them in 1982.

[75] Harris, Heather, E-mail to author, January 24, 2011.

famous “malaise” [76] speech in which he told Americans that “erosion of our confidence in the future is threatening to destroy the social and the political fabric of America.”

He shook up his Cabinet. William Miller, chairman of the Board of Governors of the Federal Reserve, left the Fed to become Treasury Secretary. And later that month, in an attempt to reassure the nervous financial community, Carter nominated Paul Volcker to succeed Miller as Fed chairman.

Volcker, a big, deliberate man who enjoyed a good cigar, liked nothing better than to fish a wilderness trout stream, but his usual habitat was Wall Street.

At the time of his appointment, he headed the Federal Reserve Bank of New York and served as vice chairman of the Fed, which has been called the fourth branch of our government. When he took over the chairmanship in August, Volcker became one of the most powerful men in the world. And he would change the economic environment in which credit unions and their competition operated.

There are two main avenues in our democracy for stimulating the economy or controlling inflation: fiscal policy, set in often erratic fashion by Congress and the President through taxes and spending; and monetary policy, set by the Federal Reserve’s control over credit and the money supply.

Because the public demands many government services but is reluctant to pay for them, fiscal policy tends to run deficits that stimulate the economy but also encourage inflation. The burden of controlling inflation thus falls mainly to the Fed.

Through the 1970s, both politicians and the Fed had been concerned mainly about risks of recession and unemployment and had usually followed a “loose money” policy—that is, they made sure credit for business and consumers was easily available.

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[76] Carter never actually used the word “malaise” in the speech. The term was used by New York Times columnist William Safire.

The Federal Reserve sets monetary policies that affect the supply of money and credit. Congress and the President affect the economy through taxation and spending. (Bigstock Photo)

As 1979 progressed, there were signs of another recession coming, which argued for keeping the money supply loose. There were some minor moves toward tightening the money supply, but nothing that indicated the Fed would take a hard-line approach.

Volcker, as second in command at the Fed, acknowledged the danger of recession, but he spoke often of the threat of out-of-control inflation.

In March 1979, he told his associates at the Fed:

"I think we are at a critical point in the inflation program, with the tide against us. If we don't show any response at all, we are giving an unfortunate signal in my judgment. I believe those concerned about inflation would find no response during this period almost inexplicable in terms of what we say regarding our worries about inflation....

"I do think we need to make some move in recognition of what has been happening on the inflation front. And I think it's

good for the stability of the economy in the long run."[77]

A few days after his confirmation as Fed chairman, Volcker began persuading members of the Federal Open Market Committee (FOMC), the group that sets Fed monetary policy, to slow the growth of the money supply.[78] Interest rates rose.

The prospects for credit unions were uncertain at best. The 12 percent limit federal credit unions could charge on loans was cheap compared to the interest members could get on certificates of deposits, remembers CUNA's chief economist Bill Hampel. Some members were borrowing from their credit union and taking the money across the street to invest in CDs.[79]

Already strapped for cash to loan, credit unions found the high interest rates caused by the Fed's tightening made it difficult even to borrow funds to lend to their members. They cut back further on their lending.

As Christmas approached, members in Anne Arundel County, Maryland, for example, found that their credit unions were rationing loans. Some credit unions had limits on loan amounts, others restricted loans for expensive items like cars, others stopped lending for boats and recreational vehicles, while some shortened repayment schedules or even completely stopped lending.[80]

"It used to be anybody could walk in here and get a car loan," Sandi Casey, manager of the Southern Maryland Telco Federal Credit Union in Annapolis told a reporter. "Now we're doing only two car loans a month."

The Fort George G. Meade Credit Union, which previously

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[77] Volcker, Paul, Federal Open Market Committee Transcripts, March 20, 1979, pp. 10, 28.

[78] The voting members of the FOMC consist of the seven governors of the Fed, appointed by the president, and the presidents of five of the 12 Federal Reserve banks located around the nation.

[79] Hampel, Bill, Interview, August 15, 2011.

[80] Credit unions...ponder halt to loans," The News, Frederick, Maryland, November 8, 1979.

gave members up to 24 months to repay loans for Christmas gifts or refrigerators or vacations, shortened its repayment time to 12 months.

S.J. Dominic, president of the Maryland Credit Union league, reported that the state's credit unions were seriously considering stopping all lending except for emergency loans. He said that the economic situation for credit unions was the worst he had seen in 31 years in the credit union movement.

Chapter 11

Taxation and Bankruptcy Issues

Bankers had been trying to persuade Congress to eliminate the federal corporate income tax exemption for credit unions since the 1950s. But in the 1970s, it was fiscal reformers who sought to eliminate the credit union tax break among others. They considered tax exemptions to be "tax expenditures," hidden subsidies for politically favored recipients..

In 1972, House Ways and Means Chairman Wilbur Mills (D-Arkansas) and Senate Majority Leader Mike Mansfield (D-Montana) proposed eliminating 54 exemptions, including the one for credit unions, unless Congress specifically renewed them. Credit unions in Canada had already lost their tax exemption and many U.S. credit unions thought their exemption would soon follow. While the Mills-Mansfield measure did not go through, the credit union tax break, like the heroine in the "Perils of Pauline" movie serial, continued to be threatened with extinction.

The Fiscal 1977 U.S. Budget for the first time included a tax expenditure analysis that estimated the revenue loss from the credit union exemption at $135 million. In 1978, President Carter submitted to Congress proposals to reform the tax system that included eliminating the exemption on the grounds that it gave credit unions an unfair advantage over commercial banks and other financial providers. The Treasury drew up a bill, introduced in the House as H.R. 12078, to carry

out the president's recommendations. However, credit union lobbyists and their allies in Congress succeeded in defeating it.

In subsequent decades, as credit unions moved into the financial midstream and became more powerful competitors, bankers would redouble their efforts to curb their growth, including ending their tax exemption.

In 1978, a very different piece of problem legislation for credit unions did pass Congress, a substantial revision of the federal bankruptcy code that went into effect in 1979. Credit unions blamed it for making bankruptcy too easy and causing an increase in credit union member bankruptcies and consequent loan losses to credit unions. In response to their concerns, CUNA and NAFCU made tightening bankruptcy legislation one of their top goals.

The events and trends of the 1970s stirred the credit union movement and caused anxiety among some managers accustomed to the traditional ways. As Richard (Doc) Heins, president of CUNA Mutual, CUNA's affiliated insurance company, put it in a speech to attendees at a Utah Credit Union League annual meeting:

"Gone are the good old days of simple, straight-forward share deductions and closed-end lending.[81] Gone are the days when the entire membership is known on a first-name basis. Gone are the days when all credit union books and records could be stored in one file cabinet drawer. . . . Gone are the days when you had only yourself or maybe one other person to worry about in operating your credit union.

"For some reason, things seemed easier, simpler and more fun than they are now. But these feelings of uncertainty and frustration are <u>good</u>. They are commonly shared. They motivate us to plan and think ahead. They are natural in a period of rapid change."[82] The feelings of uncertainty and frustration would only grow greater in the decade to come.

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[81] A closed-end loan is one where the terms are fixed and cannot be changed by the consumer. Credit card loans are open-ended, since the consumer can pay variable amounts and the loan can be extended indefinitely as long as at least some payment is made each month.

The 1980s
Era of Excess

Chapter 12

Credit Unions Continue Their Evolution

Despite the credit crunch, at the start of the 1980s, the nation's 21,981 credit unions occupied a significant place in financial services. For their 44 million members, these financial cooperatives provided a money-saving alternative to profit-driven enterprises. By law and tradition, they focused on consumer loans and savings. They held 4.4 percent of household deposits in savings accounts and money market funds and 14.0 percent of installment loans, particularly car loans. The 1980s would see an end to inflation and more flexibility for credit union lending rates, thus easing the credit crunch.

Most importantly, credit unions had grown large enough and developed service offerings broad enough to offer consumers a lower-cost alternative to the for-profit financial system. The credit union alternative would help ameliorate the growing disparity of wealth that would see incomes stagnate or even decline for the average working American, especially those

[82] Heins, Richard, "The Spirit of Today Builds Tomorrow," Keynote Speech, Utah Credit Union League Annual Meeting, March 21, 1976.

with less education and fewer job skills, while the upper middle-class and the rich prospered.[83]

As the 1980s opened, CUNA's Save Our Share Drafts (S.O.S.) campaign was in full swing. Congress received more than 150,000 letters and telegrams from credit unionists defending share drafts. "Never in my nineteen years as a legislator have I seen so much mail on a subject . . . . For the first time in my nine years as chairman of the Financial Institutions subcommittee, members come up to me on the House floor and ask when I'm giving them a bill to vote on," said Representative Fernand St Germain (D-Rhode Island).[84]

With CUNA, NAFCU, and the grassroots urging him on, St Germain submitted a bill to reverse the court decision described in Chapter 5. Congress for several years had been working on legislation to give depository institutions some relief from the economic pressures they were feeling. They incorporated the share draft bill into a broader deregulatory measure. President Carter, a fan of deregulation, supported the resulting bill and the Depository Institutions Deregulation Monetary Control Act (DIDMCA) of 1980 was passed into law. The S.O.S campaign had succeeded.

Thanks to the DIDMCA's lifting of the uncertainty over share drafts, the number of credit unions offering them nearly doubled, to an estimated 2,000, by the end of 1980.

CUNA's successful S.O.S. campaign, on top of legislative accomplishments in the 1970s, demonstrated that credit

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[83] Liberal economist and former Labor Secretary Robert Reich described the wealth disparity in this way in 2011: "Despite an economy that's twice as large as it was thirty years ago, the bottom 90 percent are still stuck in the mud. If they're employed they're earning on average only about $280 more a year than thirty years ago, adjusted for inflation. That's less than a one percent gain over more than a third of a century. (Families are doing somewhat better but that's only because so many families now have to rely on two incomes.) "Why We Must Raise Taxes on the Rich," http://robertreich.org, April 4, 2011.

[84] Hoffman, Susan, *Politics and Banking*, John Hopkins University Press, 2001, page 222. St Germain preferred to spell his middle name without a period, in the French manner, indicating a male person.

unions had considerable clout in Washington, D.C. Their political power came from their "white hat" image as serving modest- and middle-income consumers and from their success in rallying the grassroots.

Congressional reforms in the 1970s had reduced the powers of committee chairpersons and other senior members on whom lobbyists traditionally focused their efforts. Interest groups now had to extend their persuasive efforts to the rank and file in Congress.

Few things influenced members of Congress more than hearing from voters back home.[85] Just a handful of letters could make an impact, former CUNA governmental affairs executive vice president Jim Barr recalled.[86] Barr credits the state leagues with being major players in stirring up this grassroots activity.

He was new to CUNA but not to credit unions, having spent a decade as the first full-time director of the National Association of Federal Credit Unions. Barr brought with him NAFCU lobbyist Karl Hoyle to serve as CUNA's chief lobbyist.

In addition to Barr and Hoyle, there were about a dozen other staffers, including several lawyers, in CUNA's Washington office. Most of the association's two hundred or so other employees, including the president, worked at its

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[85] Of course, campaign contributions help to open the ears of lawmakers, as well. Federal election-law changes in the 1970s encouraged groups to form Political Action Committees, or PACs, to solicit voluntary contributions from members. CUNA organized CULAC, the Credit Union Legislative Action Committee, in 1973, and state credit union leagues formed their own PACs. In 1980, the movement donated approximately $110,000 to 151 federal candidates – six times more money than it did in the 1978 election year. Many state-level candidates received contributions from state PACs.

[86] Barr, Jim, Interview, March 22, 2005, CUNA Information Resource Center Archive. Barr was hired by CUNA president Herb Wegner, but by the time he took his job the association had a new CEO, Jim Williams. Barr had the title of executive vice president for governmental affairs. Williams reorganized CUNA and Barr became one of seven executive vice presidents. The only unfortunate thing about that alignment, laughs Barr, is that they were quickly anointed in the credit union press as "Snow White and the Seven Dwarfs."

headquarters in Madison, Wisconsin, where CUNA first set up shop in 1934.

As President Carter signed the Depository Institutions Deregulation and Monetary Control Act of 1980 on March 31, 1980, he declared: “This is not only a significant step in reducing inflation....It’s a progressive step for stronger financial institutions of all kinds. And it's another step in a long but extremely important move toward deregulation by the Federal Government of the private enterprise system of our country.”

In addition to saving share drafts, the **Depository Institutions Deregulation** section of the Act:

● also authorized banks and savings and loans to offer interest-bearing checking accounts, known as Negotiable Order of Withdrawal (NOW) accounts;

● raised the limit on loan interest rates for federal credit unions from 12 to 15 percent; and allowed NCUA to increase it further if need be. (Almost immediately, NCUA raised the ceiling to 21 percent, where it stayed until mid- 1982.)

● gradually phased out limits on savings account interest for all depository institutions;

● allowed thrifts to offer services like checking accounts and non-mortgage loans already offered by banks and credit unions.

● raised the amount of deposits covered by federal deposit insurance from $40,000 to $100,000.

However, in return for new bank-like powers the **Monetary Control** portion of the Act:

● subjected credit unions and thrifts to a new bank-like obligation. Just like commercial banks, they would now be required to maintain substantial reserves on deposit at the Federal Reserve. The Fed temporarily exempted smaller credit unions from having to meet the reserve and reporting requirements of the Act. It also exempted corporate credit unions, defining them as “bankers' banks,” that is, institutions

organized and chartered solely to do business with other banks and primarily owned by the banks they serve.

● allowed credit unions, along with other types of depository institutions (including federal savings banks, mutual savings banks, and savings and loan associations), to borrow from the Fed's discount window[87] to offset temporary shortages of funds. While credit unions gained access to the discount window, the Fed required they first go to the Central Liquidity Facility (CLF) operated by NCUA for such borrowings.

● allowed credit unions access to other Federal Reserve wholesale banking services, such as the Fed's check clearing system, coin and currency deliveries, and using the Fed for wire transfers of funds.

Chapter 13

Hitting at Inflation Tips U.S. into Recession

The Fed's new chairman, Paul Volcker, envisioned that tightening the money supply would signal the Fed's determination to "break the fever" of inflation, as his biographer Joseph B. Treaster put it.[88] This might lead to a recession, but he hoped it would be mild and that the economy would start growing again but with greatly reduced inflation.

The Fed has several tools to raise interest rates, which makes borrowing more expensive and thus reduces the demand for credit, leading to a reduction in the supply of money available for any purpose.

As the Fed's new direction took effect, interest rates rose, and the economy slowed. The effect was amplified when the Administration in March, 1980, persuaded the Fed to put some modest restraints on credit card borrowing and President

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[87] This term harks back to the days when bankers had to visit a teller window at a Fed bank to obtain credit. The term "discount" refers to the early method of lending involving the Fed's "discounting," i.e. lending less than the full face value of commercial paper and other securities it took as collateral.

[88] Treaster, Joseph B., *Paul Volcker: The Making of a Financial Legend*, John Wiley & Sons, Hoboken, N.J., 2004, p. 142.

Carter urged Americans to cut back on consumer borrowing. His words were heeded. Consumer credit—and the economy—"went into a tail-spin," as Robert Samuelson writes. Housing, steel, and automobiles, along with the sectors that served them, were hardest hit in the slump.[89]

Steel was already suffering from foreign competition. And the "Big Three" car manufacturers (Ford, GM, and Chrysler) also had been hurting through the 1970s as Japanese competitors led by Honda and Toyota outperformed them in quality and price. Chrysler which did not have the cash reserves of GM and Ford, was at the edge of bankruptcy and was saved only by President Carter's signing a bill early in January, 1980, giving Chrysler $1.5 billion in government loan guarantees.

The credit controls were lifted in July, 1980, and the economy began to recover. But inflation rebounded as well. Consumer prices rose 13.3 percent for the year.

With the Administration retreating from credit controls, the task of slowing inflation was left to the Fed alone. Volcker accepted the challenge, and he and his fellow governors kept the Fed's foot on the economic brake pedal. The long-range benefits would be significant, but contrary to Volcker's hopes, the short-term costs would be great.

Consumers suffered as interest rates rose while inflation remained stubbornly unchecked. "The consumer is in poor and battered condition, with no relief in sight," Jerry Lareau, president of the Consumer Credit Counseling Service, told the Syracuse (N.Y.) Herald-Journal. "We have been, and will continue to be, hit by inflation. Consumers are finding it harder and harder to find luxuries to give up, getting closer and closer to the basics. They are using credit to keep up their lifestyle, since they have already cut back all they can on their savings rate."[90]

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[89] Samuelson, Robert J., *The Great Inflation and Its Aftermath*, Random House, 2008, p. 126.

[90] "Consumer Strength Ebbing," Syracuse Herald-Journal, January 23, 1981, p. C4.

The economic outlook turned sourer as 1980 drew to a close. The Fed's Beige Book[91] summary for December of 1980 stated: “Reports from Reserve Banks this month indicate, on balance, a definite weakening in the economy, with widespread prospects for a W-shaped recession resulting from sharply rising interest rates. Bank loan demand is weak, with business loans generally holding up better than consumer loans. Mortgage lending is depressed, as rates reach as high as 16% in some districts.”

Some credit unions were getting into serious trouble as investments such as “Ginnie Maes” lost value due to rising interest rates.[92]

Chapter 14

Plant Closings Strike Credit Unions

For many credit unions, the stress went beyond lending or investment problems. Some 80 percent of the nation’s credit unions were tied to industries hit by plant closings.[93] Two hundred and ninety-eight federally insured credit unions failed in 1980, the highest since federal insurance went into effect in 1971. National Credit Union Share Insurance Fund losses jumped from $4.7 million in 1979 to $29.8 million in 1980, over a sixth of the fund’s equity.

To conserve cash, NCUSIF began using special accounting devices. Weak federally insured credit unions were issued “guaranty accounts” that enabled them to operate with low or even negative net worth (capital). Assets in failed credit unions (mostly loans) were sold at high prices to third parties with full

[91] An economic report issued eight times a year by the Fed.

[92] Ginnie Maes were a type of Collateralized Mortgage Obligation. They were government bonds based on an underlying portfolio of mortgages bought from financial institutions by the U.S. Government National Mortgage Association (Ginnie Mae). Their market value fluctuated as interest rates varied.

[93] Wheat, Yolanda Townsend, NCUA Chairman’s testimony before the Senate Banking Committee March 26, 1998.

NCUSIF guarantees against default.[94]

The state of the economy and the hostage crisis in Iran doomed Carter's reelection bid[95] The victory of Republican Ronald Reagan of California in November of 1980—with Republicans gaining control of the U.S. Senate—accelerated the move away from the New Deal philosophy of activist government born out of the Great Depression.

Nixon and Carter had been advocates of deregulation, and Reagan was even more so. The new outlook in a way was a return to 19th Century economic ideas. It drew on the thinking of Milton Friedman and other economists at the University of Chicago. It has been called "neoliberalism," "free market fundamentalism," and "monetarist economics."

The basic idea of the Chicago School of Economics, as this group of thinkers was called, was that the market was the best judge of prices, wages, and investment decisions. Government needed to shrink its role and unchain capitalism from excessive regulation to bring about a new era of innovation and prosperity that would lift all classes.

Reagan himself had little formal knowledge of economics. The former movie actor, public speaker, and governor was not interested in policy details but in a few broad ideas—less government, lower taxes and spending, stronger defense, and entrepreneurial enterprise.

His election was part of a general reaction against the "welfare state" in both the United States and Western Europe. Overseas, the British Conservative government of Margaret Thatcher was emphasizing free market principles over the social ideals of the Labour Party. And in Germany, a more conservative government led by Helmut Kohl would take office from the Social Democrats in 1982.

In the months after Reagan became president on January

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[94] Wilcox, James, "Failures and Insurance Losses of Federally-Insured Credit Unions: 1971-2004," Filene Research Institute, 2005, p. 19.

[95] A mob seized the American embassy in Tehran and held the staff hostage after the Islamic fundamentalist overthrow of the Shah of Iran. A Special Forces attempt to rescue them failed.

20, 1981, as the Fed maintained its tight money policy, the prime rate, the interest rate banks charged their best customers, rose to around 21 percent, and the economy slid into its most severe recession in decades.

Though Reagan did not have a sophisticated knowledge of economics, he was firmly against inflation, and he declared his support for Volcker and his policy. But his aides often criticized the Fed chairman.

However, as Volcker's biographer puts it: "Volcker was immovable. He believed in his mission with the fervor of a priest, and he perceived that his critics among the president's legions either did not understand basic economics or were pursuing political objectives that contradicted economics. This unyielding quality might not be ideal in many situations, but the Volcker style had certain advantages if you accepted the argument that the terrible inflation of the 1970s was in part the result of the unwillingness of previous Fed chairmen to stay the course."[96]

The automotive, steel, and housing industries remained crippled. As credit union sponsors went under or laid off employees, credit union failures in 1981 more than doubled from 1980, reaching 463.

Rising interest rates made money market funds even more attractive to depositors and billions of dollars continued to be withdrawn from banks, thrifts, and credit unions, to be invested through the money market brokerages in New York City.

State Employees Credit Union of Virginia lost about $750,000 in withdrawals by its members in a few months. At the Labor Department credit union in Washington, D.C., members lined up to withdraw their savings, while deposits dried up. "It's like having a sickness," reported Manager Lina Gray. Deposits fell from $13 million to $7 million, forcing the credit union to halt lending.[97]

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[96] Treaster, Joseph B., *Paul Volcker: The Making of a Financial Legend*, John Wiley & Sons, Hoboken, N.J., 2004, p.167-168.

While the Fed's anti-inflation policy caused hardships for Americans and many sectors of the economy, it did break the back of inflation for a generation. Credit unions entered a new age where, in part due to the removal of interest rate ceilings on deposits, savings grew faster than lending, and being "loaned out" was a thing of the past.

"For credit unions the decade of the 1980s is likely to see as much change and development as that of the 1970s," NCUA noted. "The turbulent conditions of the last two years (1979-1980) and the impact on credit unions has demonstrated that credit unions are no longer insulated from savings and credit market developments and competition. The enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 created a significant milestone in the way financial institutions will be competing in the future."[98]

Community development credit unions and their association were hit hard by the economic and political conditions of the early 1980s. The Reagan administration began dismantling federal programs for the poor. Among other steps, funding for the anti-poverty Community Action agencies dried up, notes the history of the National Federation of Community Development Credit Unions (NFCDCU). This deprived many low-income credit unions of their sponsors. The federation's federal funding also was cut, its 13 employees laid off, and the association's New York headquarters closed.

Staff member Clifford Rosenthal, who had worked in the food cooperative area before joining the federation in 1980, agreed to become the non-salaried executive director of the association and to maintain the association's office in his own home while he attended graduate school. The association was able to obtain some small grants and to begin rebuilding and eventually to pay small salaries to Rosenthal and his part-time deputy director.[99]

However buffeted credit unions were in this period, savings

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[97] Greider, William, *Secrets of the Temple: How the Federal Reserve Runs the Country*, Simon & Schuster, 1987.

[98] Foreword, 1980 NCUA Annual Report, June, 1981.

and loans were in much worse shape. As with credit unions, their cost of funds was rising as they had to pay more to attract deposits. And even then, they often had to sell some of their portfolio of fixed-rate mortgages to counteract deposit outflows. Those mortgages had lost value as interest rates rose and thus had to be sold at depressed prices.[100] The thrift industry reported losses after taxes of $4.6 billion in 1980, and thirty-two thrifts failed, compared to four in 1979.

"Virtually every S&L was insolvent on a market-value basis in 1981," comments former S&L federal regulator William K. Black.[101] The Reagan Administration, the Congress, the Federal Home Loan Bank Board, which regulated federally insured S&Ls, and the industry itself chose not to publicly acknowledge the condition of the thrifts.

One reason for this studied silence was that the thrift insurance fund, the Federal Savings and Loan Insurance Fund (FSLIC), had only $6 billion in reserves, nowhere near the amount required to cover the deposits at risk. It was feared that an outcry about the state of the industry would trigger runs on S&Ls.

Dealing with the situation would also require massive injections of either S&L or taxpayer money into the insurance fund. The industry was too wobbly to afford large premium increases, and a taxpayer bailout would have derailed the administration's campaign promises of cutting taxes, increasing defense spending, and (the economic equivalent of squaring the circle) balancing the budget. It would also have endangered funding for popular social programs.

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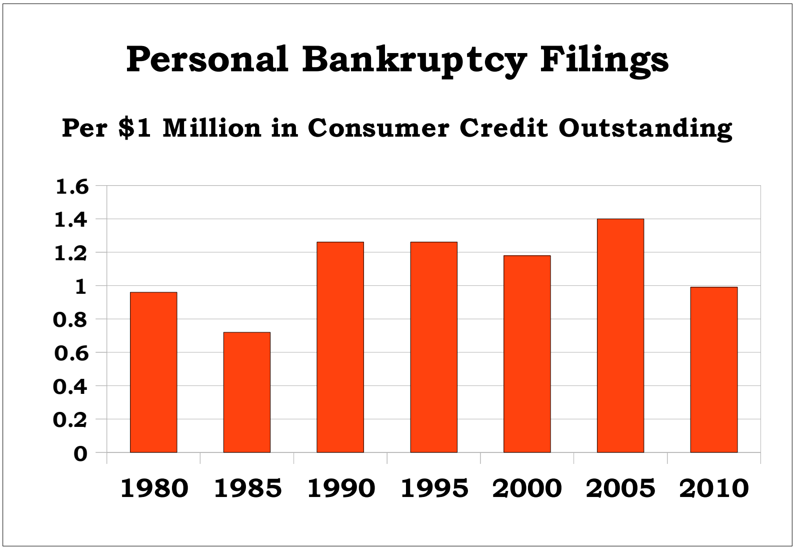
[99] Web history of the National Federation of Community Development Credit Unions at natfed.org and interview with Cliff Rosenthal, September 28, 2004, CUNA Information Resource Center.

[100] Federal and most state S&Ls at this time were required by law to offer only fixed-rate home mortgages. This protected borrowers against rises in interest rates on their loans, but the thrifts were vulnerable to interest rate spikes.

[101] Black, William K., *The Best Way to Rob a Bank Is to Own One*, University of Texas Press, 2005.

The promised tax cuts materialized in the Economic Recovery Tax Act of 1981. This act reduced marginal tax rates, and, in addition, created incentives to invest in real estate. This subsidy encouraged building for tax purposes rather than for sound business reasons, which would contribute to the regional real estate bubbles of the later 1980s, in which many S&Ls and banks and some credit unions were involved.

The year 1981 also saw the formation of CUNA's Bankruptcy Task Force, made up of managers of small and large credit unions. The task force members concluded "far too many people are filing bankruptcies who have more than enough assets or ability to repay loans." The task force agreed that many bankruptcy courts did not permit credit union members to reaffirm their debt to their credit unions even if they could afford to pay off the loan. This was the start of a long process of seeking legislative remedies and developing programs to increase member financial literacy and inform them of the pitfalls involved in bankruptcy.



While personal bankruptcies have risen roughly in line with consumer debt, the bankruptcy rate has not varied much through the years.

Chapter 15

A New Coach for NCUA's Team

The Reagan decision that most directly affected credit unions at this time was his choice in 1981 of Edgar Callahan of Illinois to succeed Larry Connell as chairman of the National Credit Union Administration.

The chairman is one of the three members of the NCUA Board, which establishes NCUA policies and the regulations that federally chartered and federally insured state credit unions must follow. The chairman directs the enforcement of these policies and regulations.

The law gives the NCUA chairman considerable powers to manage the agency, although most of the day to day responsibilities of management are carried out by an executive director. The chairman is the spokesperson for NCUA and is responsible for its relations with other agencies. The chairman determines each board member's area of responsibility.

Callahan was a native of Youngstown, Ohio, noted for its miles of steel plants. He played football for Marquette University in Milwaukee as a guard and began his career in the early 1950s as a parochial high school math teacher and coach in Milwaukee.

When he got his first teaching job in 1952, he was getting married, he recalled. He rented an apartment, and the school's head coach, who had helped him get the job because of Callahan's coaching skills, sent him down to the Milwaukee County Teachers' Credit Union. He borrowed 200 dollars. Since credit unions in those days didn't have checking accounts, he had to open up a checking account with a bank.[102]

As his career progressed, he earned a master's degree in mathematics from Notre Dame, and became a coach and administrator of the Catholic school system in Rockford, Illinois. Callahan moved into state government service,

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[102] Callahan, Ed, Interview, August 9, 2004, CUNA Information Resource Center Archive.

becoming deputy secretary of state. In 1977, the governor appointed him to lead and reform the state's problem-ridden Department of Financial Institutions, which supervised state-chartered financial institutions other than banks and savings and loans.

He hired two lieutenants:

● Wendell (Bucky) Sebastian, a state government lawyer with a law degree from Loyola University, Chicago, who served as Callahan's general counsel and unofficial deputy director, and

● Charles (Chip) Filson, who became supervisor of credit unions, overseeing the state's state-chartered credit unions, comprising the bulk of credit unions in Illinois. Filson had graduated Harvard magnum cum laude and gained degrees in business and finance from Oxford as a Rhodes Scholar. He served as a naval officer for four years before joining the First National Bank of Chicago as an international banker based in Australia.

The three of them, Ed, Bucky, and Chip, had different skills and outlooks but quickly bonded. "We jelled almost instantly," Sebastian recalled. The working relationship, he said, was "almost magical."[103]

Callahan with his coaching and school supervisory background was a natural leader, a "complete type A personality," Sebastian recalled. "I used to call him Radar O'Reilly. He heard the helicopters before anybody else.[104] His instincts, his intuition, his read of human nature—it was just unparalleled in my lifetime."

Bucky Sebastian himself was a "young radical," Filson said. "He was a change agent from the beginning. He had that unusual capacity always to see not just one way of looking at

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[103] Sebastian, Bucky, Interview, April 11, 2011.

[104] On the long-running television program MASH, about an Army surgical unit in the Korean War, Corporal O'Reilly always was the first to hear incoming helicopters bearing wounded for treatment. He was played by Gary Burghoff.

an issue, but multiple ways. He brought tremendous creativity not only to the regulatory but to the leadership process."[105]

Filson in turn was the one with a specific background in financial services and analysis. He brought a rigorous academic approach to any problem, Sebastian remembered. "He could study the problem, research the problem, dig, dig, dig deep, and get to the core . . . .Give Chip a problem and he'd come at it from 360 degrees with outstanding work."

They all had religious backgrounds – Callahan with his Catholic upbringing and teaching, Sebastian with eight years of training for the priesthood under his belt and an undergraduate degree in scholastic philosophy, and Filson, the son of a Presbyterian minister.

"And while, you know, credit unions are not a religion, they're akin to a religion, or they can be if you see them the way we saw them," according to Sebastian. "Credit unions really became a passion for the three of us."

Callahan was a great believer in credit union democracy, Sebastian recalled, and having boards rather than regulators decide methods of operation.

Sebastian noted that at that time, the regulatory approach both in Illinois and Washington, D.C., was if the law "doesn't say you can do it, then you can't do it. And our approach was, if it doesn't say you can't, then we think you can. We're not going to tell you (that) you should. You should decide for yourself . . . but here are the caveats— we're going to check on you, we're going to supervise you, we're going to play the role we're supposed to play. But unless and until you get into trouble, we're not going to substitute our judgment for yours."

The team expressed its deregulatory bent early on in overseeing Illinois credit unions. The first day Sebastian arrived at his job as general counsel of the Illinois agency, he found an application on his desk requesting authorization for state-chartered credit unions to offer share drafts. That was

[105] Filson, Chip, Interview, May 20, 2011.

approved, and Illinois bankers sued the next day, adding the state to the roster of several involved in the share draft battle.

State law set interest rates for credit union loans, but the regulator set terms on savings. Early in Callahan's Illinois administration, Filson designed an eagerly awaited new type of savings account to meet credit union needs. Callahan's advisory board of credit unionists met to endorse the new type of share account.

Callahan told the advisory board he wasn't going to approve the new product. The board members' faces dropped, he recalled. Callahan let the statement settle in and then explained: that he thought the new product was a great idea, but he was concerned that if it became popular and turned out to be a bad idea, Filson would have become the pied piper of Illinois credit unions

Callahan told the board he didn't think that was the role of government but the responsibility of the boards of directors. So he was deregulating savings, he told the group. It would henceforth be the responsibility of credit union boards to set the terms and conditions of savings products.[106]

Callahan was one of three names proposed by CUNA for the post of NCUA chairman. He believed his reputation as a deregulator led to President Reagan's selecting him. At his Senate Banking Committee confirmation hearing, he was introduced by Representative Lynn Martin (R-Illinois) who jokingly told the committee that "we have to give him this job" because "he has tons of children." (He had eight.)

Callahan took his two deputies with him to Washington, D.C. Filson was placed in charge of NCUA's office of examination and insurance, the National Credit Union Share Insurance Fund, and the Central Liquidity Facility. Sebastian became general counsel and executive director of the agency. The three would leave a lasting mark on the credit union movement during their time in office.

[106] Callahan, Ed, Interview, August 9, 2004, CUNA Information Resource Center Archive.

The Callahan team arrived in Washington, D.C. in late 1981. Nineteen Eighty Two looked to be another rough year for workers and their credit unions. As a result of the Fed-induced recession, unemployment was rising toward its highest levels since World War II.

The new team was a colorful addition to the Washington scene. Ralph Swoboda was CUNA's general counsel at the time. In a get-acquainted meeting with the trio, Swoboda and several other visitors found themselves being shouted at. Then Callahan, Sebastian, and Filson began shouting at each other. "It wasn't anything hostile," Swoboda told the author. "It was just the way they argued out issues."[107]

Callahan was not Mr. Congeniality, recalled Robert Fenner, then a staff attorney who later became NCUA's chief counsel. Callahan was interested in getting results and getting them quickly. He wasn't particularly sensitive to people's feelings. But Fenner said he did not have a problem working for him. The attorney always knew what Callahan wanted. [108]

Advocates of "lean and mean" management, Callahan and Sebastian at one point trimmed 75 positions, which did not endear them to employees.

"That was not popular," Sebastian later told the American Banker. "At the end of the day, I was in a crowded elevator and no one said a word. It was 80 degrees outside, and it felt like it was 40 degrees in the elevator."[109]

Chapter 16

Field of Membership Expansion

Callahan found that his agency's policy on field of membership, which generally restricted employee-based federal

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[107] Swoboda, Ralph, conversation with author, May 15, 2012.

[108] Fenner, Bob, Interview, December 17, 2004, CUNA Information Resource Center Archive.

[109] "The Hard-Driving Boss Who Shook Up GTE Federal," American Banker, September 18, 1995, Vol. 160, Issue 179, p. 13.

credit unions to serving one location, made it difficult to salvage credit unions hit by the recession.

In such a case, the credit union had only a few alternatives to liquidation:

(1) merging with another credit union at the same workplace;

(2) switching to a community charter; or

(3) switching to a state charter if the state regulator would allow it to merge with another state credit union having a different common bond.

The recession hit hard at steel plants like this one, forcing many credit unions to close. (Library of Congress Photo)

As Callahan explained to the Association Press: "The week I came to this job in the fall of 1981, the agency had just liquidated a Veterans Administration hospital credit union in Baltimore because it didn't have a common bond with the VA

hospital in Washington. I was appalled."

Steel plants were shutting down, and "every one of them had a credit union." So with auto factories, tire makers, and trucking and lumber companies.[110]

At Christmas, Callahan visited his family in Youngstown, Ohio, his hometown. "Steel Valley" was suffering from the closure of its remaining plants. Sebastian remembered that Callahan "came back and he said, 'We've got to do something. We've got to figure out a way to keep from liquidating these credit unions . . . when members need them the most.'"[111]

The team scoured the 1934 Federal Credit Union Act to see what might be done. The Act limited federal credit unions' fields of membership to "groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community or rural district."

Sebastian issued a legal opinion broadening the interpretation to allow a federal credit union to serve more than one group as long as each group had its own common bond. In April, 1982, NCUA revised its field of membership requirements to allow employee and associational federal credit unions to merge with credit unions with different common bonds or to add small groups with dissimilar common bonds.

The rationale for the change was that each group still had its own common bond even though merged into one credit union. In a speech to the Credit Union League of Massachusetts the following year, Callahan explained: "We took the law that had been on the books for nearly fifty years and gave it a more liberal interpretation. This has permitted credit unions to extend service through what we call the group theory. For credit unions in auto, steel, and rubber manufacturing plants, this is an opportunity to bridge a very difficult time."[112]

A month after the policy change, troubled Braniff Airways

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[110] "Credit unions well and thriving," Syracuse Herald-Journal, Tuesday, August 28, 1984.

[111] Sebastian, Bucky, Interview, April 11, 2011

of Texas grounded its flights and went into bankruptcy proceedings. Under the NCUA's new policy, the airline's credit union was allowed to take in a number of new groups in the Dallas-Forth Worth airport area, and it was able to stabilize its finances without liquidation.

But the impact of the new policy went far beyond the credit unions at risk in 1982. It reduced demands on the National Credit Union Share Insurance Fund. It made voluntary mergers among credit unions with different common bonds much easier. And it gave small groups an avenue to credit union membership that would have been difficult to achieve under increasingly rigorous chartering requirements.

Another of the Callahan team's actions in 1982 was to double-check the condition of federal credit unions. The traditional annual examination schedule had deteriorated to once every 21 months and in some cases even 24 months. In response, NCUA put its examiners on the road in a massive "fire drill" nicknamed "Massive Attack by Callahan's Examiners" or "MACE."

The examiners were required to visit all 11,430 federal credit unions between February 16 and March 19. The visits weren't formal examinations but quick "hands on" looks at these credit unions, "some of which hadn't been visited in two years," according to NCUA's 1982 Annual Report. "Those that needed help would get it quickly—before they became weak."[113] Over the next few years, the regular examination schedule would be annual.

Chapter 17

New Responsibilities for CU Boards, Managers

CUNA and the credit union movement had been pushing for some years for greater flexibility for credit union boards,

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[112] Callahan, Ed, 1983 NCUA Annual Report, National Credit Union Administration, 1984, p. 5.

[113] 1982 NCUA Annual Report, 1983, p. 37.

and Callahan fully agreed. As Callahan was preparing to depart for Washington, the Illinois credit union league gave him a sign summarizing Callahan's approach. It said: "We do not run credit unions." He posted it outside his office door at NCUA.[114]

As Callahan explained to a meeting of the National Association of Federal Credit Unions: "It is not the place of government to run credit unions. I don't believe I should be running one. While I have had some experience as a regulator in Illinois, I have never worked in a credit union. I have never made a loan. I've never tried to collect on a bad debt. I am very uncomfortable sitting on a panel deciding what are competitive instruments to help you compete in the marketplace."[115]

In 1982, Callahan and the NCUA board voted to give federal credit unions much the same flexibility state-chartered credit unions in Illinois had gained under the Callahan regime. Federal charters were allowed to determine the terms and conditions of all savings accounts (at a time when other depository institutions had not yet gained similar flexibility.) In 1983, NCUA allowed federal charters to decide for themselves what constituted a family member, rather than restricting membership to the immediate households of primary members.

In the midst of this flurry of NCUA activity, Callahan received a report from the General Accounting Office (GAO) criticizing aspects of NCUA's supervision of federal credit unions and federally insured state credit unions.[116] In his response, Callahan outlined what had already been accomplished and what he planned to do in the future.

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[114] The sign now hangs in the office of Callahan and Associates in Washington, D.C.

[115] 1982 NCUA Annual Report, National Credit Union Administration, 1983, p. 3.

[116] "Stronger Supervision of Credit Unions Needed," Report to the Chairman of the National Credit Union Administration, General Accounting Office, October 6, 1982.

Among other things, the GAO report noted the heavy reliance NCUA placed on state credit union examiners to check on federally insured state charters. State credit union regulation was usually housed in the state's banking department.

In a survey by NCUA in 1981, its regional examiners reported that in their opinion, 17 of the 44 state examination programs were inadequate. The GAO suggested steps NCUA should take to gather more insight into state examination procedures, steps that Callahan believed were not necessary. But in coming years, NCUA and state regulators would work together to strengthen state programs and divide responsibilities among federal and state authorities. This would be done through the National Association of State Credit Union Supervisors (NASCUS), founded in 1965.

Over the decade, the fate of the credit union movement would be intertwined in various ways with the fate of the savings and loan and commercial banking industries as they all sought to survive the new competitive marketplace opened up by legislation.

As a follow-up to earlier legislation, the consensus in the Reagan administration and in the S&L industry was that thrifts needed new powers that would allow them to earn their way out of their problems. Gone would be the tight focus on promoting home ownership. S&Ls and their New England cousins, the mutual savings banks, needed to branch out into other lines of business.

The Garn-St Germain Depository Institutions Act of 1982 was largely written by the Federal Home Loan Bank Board and a Treasury Department official. President Reagan signed it in October of that year. The act was concerned with giving more powers to savings and loans and mutual savings banks, but for federal credit unions it also:

- made the credit committee optional
- allowed mortgage loans for more than 30 years

● allowed second mortgage loans for any purpose, not just home improvements, and

● permitted federal credit unions to invest in state and local government operations.

The combined effect of the legislation of the 1970s and early 1980s and the changes in NCUA policy thrust credit unions into a new era of freedom in the midst of economic turmoil. But were they prepared to handle their freedom?

Credit unions, especially smaller ones, were relatively unsophisticated when it came to financial matters. As long-time credit union association leader Pete Crear noted to the author, the main skills a credit union manager needed before the 1970s were keeping a set of books and overseeing routine operations. Asset Liability Management, investment analysis, strategic planning, marketing and other responsibilities included in the job descriptions of today's upper management were foreign territory to many managers.

Most boards were similarly limited in their conception of their tasks and in financial know-how. They were accustomed to their regulators telling them what to do and how to do it.

At this time, the Credit Union National Association and its leagues were trying to educate credit unions on the capital problems of the movement. "A surprising amount of this is well over the heads of elected officials and simple concepts such as the calculation of the capital ratio of a credit union appeared to be a startling new feature to many . . . . I can see we have a great deal of education ahead of us," Wisconsin League President John P. Hill noted.[117]

Credit unions now had much broader discretion to decide their strategies, observed economist and long-time credit union director James Likens, but "the reaction of most credit union leaders to having more responsibilities thrust on boards by Callahan was largely, 'Decide what? Who, us?'" [118]

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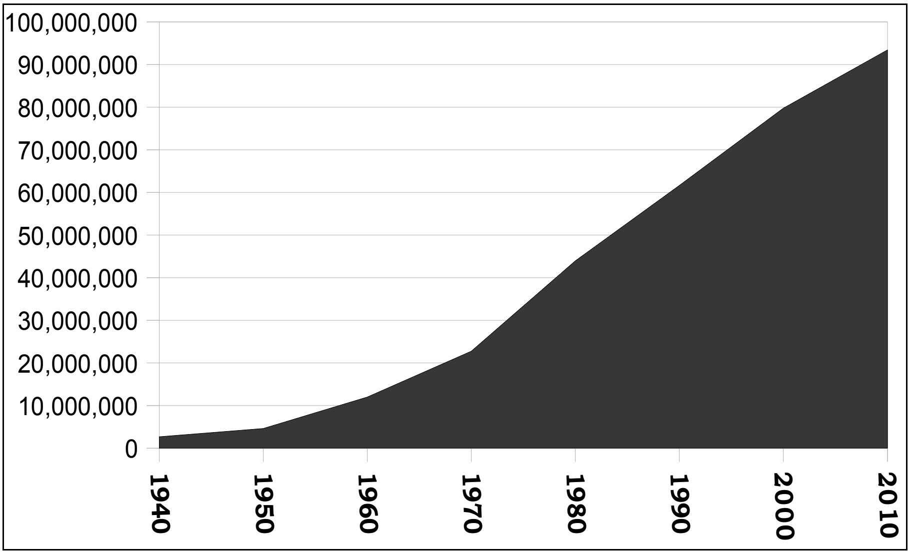
[117] Hill, John P., Letter to Brad Murphy, October 27, 1982.

[118] Likens, James D., "Credit Union Directors – From the Past to the Future," Insights, Western CUNA Management School, April 2002.

CU Membership Growth



Thanks to more liberal regulation, credit unions had room to grow in coming decades. (Data from Credit Union National Association)

Credit unions had some strengths going for them. Their primary activity was in the safest part of the financial industry, consumer loans. Credit unions entered the 1980s much stronger financially than the S&Ls. As cooperatives, they felt their responsibility was to their members, not to private stockholders looking to maximize profits, and they largely kept their focus on member service. This helped them stay on a conservative, prudent course rather than taking on risks. They worked in collaboration with each other, sharing resources and experience rather than following a philosophy of "every credit union for itself." And they had a strong and active federal regulator, which, while giving them more freedom, was also providing muscular oversight.

Sebastian believes deregulation strengthened the movement, that it "allowed the best and the brightest and the most outstanding to thrive in ways they never would have been

able to if they were still having to call NCUA every Monday to learn what rates they could pay."[119] Certainly, the Callahan administration's policies kept the door open for future growth in size and membership.

Chapter 18

S&L and Bank Problems Singe Credit Unions

With their expansive new powers, many savings and loans lost their way in the new financial landscape. A number of thrifts were switching from mutual (member) ownership to stock ownership, especially in Texas and California. They drifted from their service-focused mutual roots to seek quick profits in often-risky lending and investment ventures.

This drift from the fundamentals was abetted by weak regulation. The federal regulator, the Federal Home Loan Bank Board (FHLBB), along with some of its state counterparts, was poorly organized, understaffed, and under-funded. Initially, it cooperated with the Reagan Administration to downplay the industry's problems and find ways to keep floundering S&Ls afloat through creative accounting and mergers, anything to avoid liquidation.

This forbearance, combined with deregulation, created a climate for get-rich-tactics and fraud.[120] But while "fraud played a role in some S&L failures, the vast majority of these insolvencies resulted from ill-advised lending decisions and the inability of managers to respond to the problems associated with rapid growth." comments British scholar David L. Mason.[121]

Mutual (member-owned) thrifts would weather the coming

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[119] Sebastian, Bucky, Interview, April 1, 2011.

[120] Black, William K., *The Best Way to Rob a Bank Is to Own One*, University of Texas Press, 2005. Black was a regulator with the Bank Board.

[121] Mason, David L., *From Buildings and Loans to Bail-Outs: A History of the American Savings and Loan Industry* 1831-1995, Cambridge University Press, 2004, p. 5.

storm better than the stock-owned S&Ls.[122] "Significantly, a common trait among the thrifts that survived the 1980s was that they approached deregulation more cautiously and remained focused on meeting the consumer finance needs of their local service territories," Mason notes.

The commercial banking industry, too, was getting into troubled waters in the search for profits. The number of bank failures per year rose through the 1980s, from 22 at the start of the decade to 534 in 1989.

Even if newly deregulated credit unions avoided the financial shoals, they faced the danger of getting caught up one way or another in the growing turbulence of the savings and loan and banking industries. They were not always successful in this.

Their comparative naivete about investments was coming back to bite them. We've already seen how investments in Ginnie Mae securities of the U.S. Government National Mortgage Association, got a number of credit unions into trouble as interest rates rose.

As their loan to savings ratios fell due to the early 1980s recession, credit unions were looking for places to invest their surpluses. The corporate credit unions offered one place to park funds, but corporates themselves needed places to invest surplus cash deposited by credit unions. Many credit unions, including corporates, were hearing the call of brokered deposits.

Banks and savings and loans looking for deposits to loan out in the new deregulated environment offered higher than average interest rates to attract CD deposits from large investors. These rates were broadcast nationally through a fast-growing number of deposit brokers like Merrill Lynch.

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[122] Barth, James R., Carl D. Hudson and John S. Jahera, in *S&L Closures and Survivors: Are There Systematic Differences in Behavior?, The Causes and Costs of Depository Institution Failures*, edited by Allin F. Cottrell, et al, Kluwer Academic Publishers, 1995, p. 9. A white paper prepared by the author of this history for CUNA President Ralph Swoboda also showed that mutual thrifts failed less often than stock-owned institutions.

An institution seeking to earn a good rate on its surplus funds could look to its favored broker to tell it which banks and S&Ls offered the best rates, and if a CD purchase resulted, the broker received a commission. These brokered deposits were nicknamed “hot money,” because they flowed from one institution to another in search of ever-higher rates.

The more cautious depositing institutions split up their CDs so that no more than $100,000 went to any single bank or thrift, ensuring their deposits were fully covered by FDIC or other federal insurance.

In many cases, however, the depositors relied on past experience that the deposit insurance funds would not ordinarily liquidate a failed institution but would merge it into another, stronger institution, thus protecting all deposits regardless of the insurance limits. So on occasion they invested above and beyond the $100,000 insured limit.

Some credit unions thus lost uninsured money in May 1981, when the small Economy Savings and Loan in Chicago, with deposits of $69 million, was shut down by its federal regulator. Like other savings and loans, Economy was caught in an inflationary squeeze, paying up to 15 percent for its funds but earning only 10 percent on its mortgages. It also had lost money by speculating in government securities. As FSLIC, the S&L insurance fund, was accustomed to do with other troubled S&Ls, it tried to find a merger partner, but Economy was in so deep no takers could be found, and it became the first S&L in a decade to be liquidated by the Bank Board.

Chapter 19

Penn Square Bank Collapse

“How were some of the nation’s most sophisticated financial institutions, with all varieties of experience on hand, lured like moths to the glow of this go-go bank sitting in a shopping center in Oklahoma City? And how did so many small financial institutions decide, in effect, to delegate their

judgments and responsibilities to brokers who peddled Penn Square's get-rich-quick interest rates like cotton candy at a carnival?" fumed Representative Fernand St Germain (D-Rhode Island) as he opened hearings on one of the nation's largest bank failures to date.[123]

The Penn Square Bank collapse snared many credit unions. (FDIC Photo)

St Germain was looking into the shutting of Penn Square Bank, with assets of $511.3 million, which was closed at the start of the Fourth of July weekend of 1982 by the Comptroller of the Currency. The Federal Deposit Insurance Corporation (FDIC) took over Penn Square's assets and debts. The failure came some ten months after the Callahan team arrived in Washington.

As Chairman St Germain noted, Penn Square began as a small bank in an Oklahoma City strip mall. When oil and natural gas prices rose in the 1970s, peaking in 1979-81, a speculative boom began in the Southwest's "Oil Patch." Like

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[123] Hearings Before the Committee on Banking, Finance, and Urban Affairs, House of Representatives, 97th Congress, Second Session, Part 1, July 15 and August 16, 1982.

most booms, it didn't seem speculative at the time, but a sure-fire way to make money hand over fist. "There was an electricity in the air," Oklahoma City Attorney M.C. Kratz recalled.[124] It seemed like everybody and his brother was getting into the oil and gas business.

Bill (Beep) Jennings, an ebullient banking marketer who "could sell sand in the Sahara" bought Penn Square Bank in 1975.[125] Jennings was willing to lend large amounts on dubious ventures, often not requiring adequate documentation.

To get the funds to lend to oil drillers and others in the industry, Penn Square offered loan participations to banks around the nation and offered high rates of interest on deposits. It paid a fee to brokers for bringing in deposits. Between the loan participations and the brokered deposits, "…the little bank grew fifteen-fold in seven years, becoming the money broker for hundreds of energy firms," the Associated Press reported.[126]

But the recession, combined with new non-OPEC oil production, burst the price bubble, and the Oil Patch went into a steep decline. Many of Penn Square's energy loans became bad paper. Lax internal controls and outright fraud also weakened the bank, as later criminal indictments would demonstrate. After several efforts to get the bank to straighten up and fly right, the Comptroller of the Currency shut it down at 6 p.m. Friday, July 2. Examiners swarmed in to look at the books and found dozens of credit unions had deposits in the bank.

The NCUA Board, which customarily met in Washington, D.C., was trying to make it easier for credit unions to attend its meetings by holding some in other locations. At the time of the Penn Square closure, Callahan and Filson were en route to

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124 Zweig, Phillip L., *Belly Up: The Collapse of Penn Square Bank*, Fawcett Columbine, 1985, p. 111.

125 Ibid., pp. 22-40.

126 "Penn Square collapsed year ago; today liquidation still going on," Syracuse Herald-Journal, July 5, 1983.

Chicago for a board meeting, visiting families on the way. Bucky Sebastian hadn't yet departed Washington, and was at home the Friday evening the federal authorities moved to shut down Penn Square. He fielded calls in quick succession from Todd Conover, Controller of the Currency; William Isaac, head of the bank insurance fund, the FDIC, and Fed Chairman Paul Volcker. They were all asking, what were credit unions doing investing in this strip mall bank? "And I was like, sir, I don't know," Sebastian recalled.[127]

Scrambling to find answers, he called NCUA headquarters and found Layne Bumgardner, of the office of examination and insurance, still working. Bumgardner called in a handful of other NCUA staff. Sebastian and the staffers spent the night trying to find out the extent of credit union involvement.

In Chicago, the National Association of Federal Credit Unions (NAFCU) held its meeting the following week, and the NCUA Board meeting followed. NAFCU delegates who stayed for the NCUA meeting were disturbed, to say the least, when it was announced that among Penn Square's 24,000 plus depositors were credit unions that had invested millions of dollars over the deposit insurance limit of $100,000. The credit unions losing part of their money in Penn State ranged from five corporates to various federal government credit unions to a Catholic parish federal credit union in Royal Oak, Michigan.

The full extent of the losses was not immediately clear, but according to the FDIC, 139 credit unions around the nation had invested a total of more than $111 million over the deposit insurance limit. The FDIC estimated they would get most of that back when the final settlements were made.[128]

Callahan in Chicago said the credit unions were absorbing the losses but would have serious earnings problems as a result. "It came as a surprise to us that such a large number of credit unions had so much money concentrated in a

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[127] Sebastian, Bucky, Interview. April 1, 2011.

[128] NCUA 1982 Annual Report, National Credit Union Administration, 1983, p.6. It is not known what losses, if any, may have been incurred by privately insured, state-chartered credit unions.

relatively small, obscure bank in Oklahoma," he told the Chicago Tribune.[129]

Most of the credit unions had been relying on a list of 45 high-rate-paying institutions distributed, along with key financials, by a California investment firm, Professional Assets Management, respected by the credit union community.[130] The stung credit unions were not alone. The failure of Penn Square affected some of the nation's biggest banks through their participation in Penn Square's soured loans to the oil industry.

The involvement of credit unions touched a nerve among lawmakers in Congress. House members may have been especially irked that their own Wright Patman Federal Credit Union was among those possibly losing money. St Germain and other lawmakers demanded to know why credit unions were allowed to invest in a troubled bank. Here they ran up against the practice of regulators not to make public the identity of problem banks for fear of starting runs by depositors.

NCUA's response was that the credit unions involved had broken no laws or regulations and they had sufficient income and reserves to cover the losses without drawing on their insurance fund.

Decisions where to invest funds should be left to boards of directors, Executive Director Sebastian said at a Government Operations subcommittee hearing July 16, 1982. He pointed out that "If we call a credit union and tell them we have inside information that a given bank is in trouble, take your money out, it's my opinion that we would be responsible for the demise of that bank."[131]

CHAIRMAN BENJAMIN ROSENTHAL (D-N.Y.): "From this point forward, you are going to continue to do business as you

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[129] "Credit unions' giant loss raises questions," Chicago Tribune, July 11, 1982.

[130] Ibid.

[131] "Credit unions lost millions in Penn Square Bank bust," (AP) Galveston Daily News, July 17, 1982.

have done in the past? If some advisory service lists a bank and the bank's doors are open, your (credit union) people are going to go in there and deposit their money?"

WENDELL SEBASTIAN: "I would say that was true."

ROSENTHAL: "You are living in a never-never land. Do you know how many problem banks there are presently on the Comptroller's list?"

SEBASTIAN: "I read it in the paper the other day, in the 200's."

ROSENTHAL: "Do you think your clients – your credit unions – should continue to deposit in the 200 problem banks?"

SEBASTIAN: "I have the impression that if the Comptroller were to print those names, all of those banks would probably experience a run and be closed within a short period of time."

ROSENTHAL: "A run in Texas is going on right now. Aside from that, do you not think your credit unions are entitled to something more than the kind of Saturday Evening Post descriptions they are getting by way of their advisory services?"

SEBASTIAN: "You know they subscribe to everything from the Wall Street Journal to the different newsletters and advisers, and they make their own decisions. And the position of our agency has been that the business decisions of the credit unions rest with the management or the board of that credit union, and not with our agency."

Rosenthal called on NCUA to "exercise more vigorous supervision over credit unions' investments."[132]

Syndicated financial columnist Sylvia Porter—whose column reached up to 40 million people—echoed Rosenthal's scolding. After Sebastian expressed NCUA's view to her associate, George Bookman, she wrote: "I am not reassured by Sebastian's answers or his philosophy that losses such as this are all in a day's work . . . .These are areas where tightening of the rules on credit unions are imperative. It's our money we

[132] "Credit unions hit hard by bank failure," (AP) Santa Fe New Mexican, July 22, 1982.

entrust to credit unions. We don't want to risk it in questionable oil loans, even if today's Washington officials consider that to be a normal 'business risk.'"[133]

What lessons could be drawn from these events for credit unions? Despite Porter's displeasure, few in the credit union movement would have favored stricter regulations on investments. But CUNA President Jim Williams noted that the Penn Square losses "should make every financial manager very aware of the serious risks involved in this type of investment."[134] The prudent manager would realize that loans were a more productive and profitable investment than brokered deposits in other institutions.

It was also clear that individual credit union decisions could affect the reputation of the entire movement and stir up the wrath of legislators. No regulatory or legal reforms resulted in the immediate wake of Penn State, but soon the Administration and Congress were taking a close look at the traditional credit union exemption from income taxes.

Chapter 20

The "One Percent Solution" to Insurance Fund Problems

As the recession deepened in 1982, more than 24,000 businesses failed. Unemployment rose to near 11 percent. People were talking of another Depression. Reagan's popularity sank toward Carter levels, and in the 1982 mid-term congressional elections, Democrats made big gains in the House of Representatives, although the GOP held on to the Senate.

However, inflation was coming down, and Volcker's Fed began gradually loosening credit. By 1983, the economic

[133] Porter, Sylvia, "Your Money's Worth: How many Penn Squares?," Syracuse Herald Journal, August 4, 1982.

[134] "Bank Failures Won't Affect CUs' Solvency," Credit Union Magazine, August,1982. p. 16.

outlook began to improve, and the President's popularity began to bounce back.

Ed Callahan did not have many opportunities to meet with the President, but when the two crossed paths, they usually discussed football, because Callahan had been a football coach in Rockford, Illinois, and Reagan, before Callahan's time, had played football in Dixon, Illinois. It was a topic Reagan relished and liked to remember, Callahan recalled. Reagan would not hesitate to halt Callahan in a reception line to talk football.[135]

Callahan had more contact with Vice President George H.W. Bush, who headed the Task Group on Regulation of Financial Services, of which Callahan was a member. Its job was to look at the financial marketplace and determine what more regulation might be needed. It met in the dining room of the vice president's official residence.

The Task Force found that NCUA "seems to be working just fine," reported staff director Richard Breeden to a meeting of the National Association of Federal Credit Unions. "No one from the Task Group has come forward with serious suggestions for changing or altering the credit union system in any way."[136]

Not so the presidential Private Sector Survey on Cost Control, dubbed the Grace Commission after its chairman, Peter Grace. Its task was to study ways to cut government costs. It praised NCUA for its deregulatory measures, but made several recommendations of serious concern to the credit union movement. These recommendations were that:

● The Central Liquidity Facility should be scrapped, and credit unions should rely on the Federal Reserve's discount window for loans.

● Share insurance premiums should be based on the risk a credit union posed to the insurance fund, rather than having

[135] Callahan, Ed, Interview, August 9, 2004, CUNA Information Resource Center Archive.

[136] 1983 NCUA Annual Report, National Credit Union Administration, 1984, p. 28.

every credit union pay the same premium.

- Credit unions should be taxed.[137]

The first two recommendations came to naught. The third soon became entwined with the future of the National Credit Union Share Insurance Fund (NCUSIF).

The Penn Square events set NCUA to looking more closely at NCUSIF. Unlike the bank and thrift insurance funds, NCUSIF had received no "founding money" from the U.S. government. It began to accumulate funds by charging an annual premium of 0.0833 on the total of members' accounts and creditor obligations.

At that point, in the 1970s, credit unions offered few savings vehicles except passbook savings, and the average account was around $650. So the premium was enough to cover losses and gradually accumulate a reserve. In 1979, the NCUSIF equity ratio—the ratio of money in the fund to the total savings insured—stood at 0.32 percent, or 32 cents for every hundred dollars insured.

As mentioned previously, many state charters refused to join NCUSIF because they did not want NCUA oversight and regulation. In 1981, when California established the California Credit Union Share Guaranty Corporation, there were 16 private insurance funds, covering 3,150 credit unions with $12 billion in deposits.

The recession years 1980-82 hit NCUSIF hard, and the fund had the added burden of privately insured credit unions switching to federal insurance in a "flight to safety." By 1982, when insurance losses cost the fund a record $51.4 million, the equity ratio had dropped to 0.259 percent, and the NCUA Board responded by charging credit unions a special premium and again in 1983.

Insurance losses had dropped sharply by that time, due to the economic recovery, to $15.2 million, two-thirds of which was the cost of the failure of NAFCU Corporate Credit Union,

[137] Ibid., p. 27.

serving the members of the National Association of Federal Credit Unions.

At the end of 1983, NCUSIF's equity ratio stood at 0.29 percent. But NCUSIF's various guarantees to prop up credit unions and underwrite the sale of credit union assets now nearly equaled its equity. While credit union failures were down sharply, the fund appeared to be heading for bankruptcy.

The leading credit union associations were well aware of the situation and of the need to bolster the fund. They worked closely with top NCUA officials on the issue. Clearly the key issue in the 1980s was capitalizing the share insurance fund, recalled Kathy Thompson, senior vice president of regulatory compliance for CUNA. Credit unions couldn't exist the way they are today and be as independent and have the powers they have if CUNA and NAFCU and NCUA hadn't worked together on the issue, she opined. She gave Ed Callahan a tremendous amount of credit for being creative about how to do it.[138]

The Callahan team drew on the experience of the private insurance funds, which generally required member credit unions to deposit an amount equaling one per cent of their insured savings into the reserves of their insurance fund, to be used to reimburse depositors if a credit union failed.

Callahan proposed what came to be called the One Percent Solution to the federal fund's problem. The proposal was for federally insured credit unions to recapitalize the fund by depositing with the fund an amount equal to one percent of their insured shares.

Details of the "One Percent Solution"

A credit union's deposit would remain in the National Credit Union Share Insurance Fund (NCUSIF) as long as the credit union was federally insured. If the credit union's share savings grew, as they usually did, the credit union would each year add

[138] Thompson, Kathy, Interview, December 17, 2004, CUNA Information Resource Center Archive.

to its deposit an amount sufficient to bring its deposit back up to one percent.

The credit union's deposit would be part of the fund's reserves and be counted as an asset of the fund. The federal fund would use its reserves to pay off insured savings if a credit union failed or was liquidated.

The credit union could count the deposit as an asset as well, since it would be returned to the credit union if the credit union dissolved itself or, in the case of a state charter, switched to private insurance. Thus, the deposit counted toward the net worth of the credit union, as did any other asset, although it could not be counted as part of the credit union's capital.

The statutory goal set for the federal insurance fund was reserves equal to $1.30 for every hundred dollars of insured savings. If reserves fell below that mark, the fund could charge its insured credit unions a premium to add to their one percent deposit. This was a straight expense to the credit union. Ordinarily, as it turned out, the reserves of the fund would most years be enough to make such premiums unnecessary. If the fund's assets rose above the $1.30 per hundred dollars mark, NCUSIF could declare a dividend to participating credit unions.

Operational expenses of the insurance fund would be paid out of interest earned by the fund's balance.

Many credit unions were unenthusiastic about handing all that money over to Washington. Callahan and his team promoted it vigorously. He hit the road and went to every state and gave all the speeches he could, he remembered.[139] The movement grassroots swung around in support, and so did Congress.

The recapitalization had the side benefit of heading off taxation. Senate Finance Committee Chairman Robert Dole (R-Kansas) had announced that his committee would consider taxing federal credit unions as part of an effort to reduce the

[139] Callahan, Ed, Interview, August 9, 2004, CUNA Information Resource Center Archive.

federal deficit. But Senate Banking Committee Chairman Jake Garn (R-Utah) supported the tax exemption. In correspondence between the two lawmakers, they agreed that the recapitalization of NCUSIF would be an acceptable substitute for taxation. Since the federal government operates on a cash basis, the credit union one percent deposit would actually reduce the federal deficit, even though it would remain an asset of the credit union.

The recapitalization was passed by the House-Senate Conference in June 1984, as part of the Deficit Reduction Act, and signed by President Reagan in July.

In January 1985, nearly 15,300 federally insured credit unions sent checks into NCUSIF, in amounts ranging from less than $200 to almost $200 million. The total of some $800 million raised the fund's equity ratio from 0.27 percent to over 1.30 percent within a few days. This put the fund in a strong position to weather the coming economic storms—and in the first year gave the federal government more "revenue" than it would have received by imposing an income tax on credit unions.

Feeling their mission accomplished, the Callahan team agreed among themselves to leave NCUA in search of new opportunities. Callahan resigned his chairmanship May 3, 1985, and with Chip Filson founded Callahan & Associates in Washington, D.C., Filson eventually took over as head of the firm after Callahan went on to become CEO of Patelco Credit Union in San Francisco. Bucky Sebastian became president of GTE Federal Credit Union in Tampa and, after a long career there, executive director of the National Credit Union Foundation.

By the end of their administration, recalled Sebastian, the agency was spending almost 10 per cent less than before they arrived, had fewer employees but more staff involved in supervising credit unions, and was on an annual examination basis. "And we believed that the credit union system was

healthier in every aspect the day we left than it was the day we got there."[140]

President Reagan appointed Roger Jepsen to the remainder of Callahan's term. A former Army paratrooper and reservist, Jepsen was active in farming, insurance and health care businesses. He entered Iowa politics and eventually was elected to the U.S. Senate. Losing his bid for reelection in 1984, he became NCUA chairman in October, 1985, and later won a full term as chairman, serving until 1993.

Jepsen, white-haired and courtly, fit the stereotype of a Senator. He was a genial administrator who worked well with the credit union movement but left much of the detail work to his subordinates. Some credit unionists believed that the NCUA had lost muscle as well as fat under Callahan's tight administration. Jepsen began rebuilding its staff and eventually had a new and controversial (because of its cost) headquarters built.

Chapter 21

The Unresolved S&L Mess

An improving economy, together with annual examinations, brought the number of federally insured credit union failures down as the 1980s progressed. From a peak of 463 in 1982, the total number of failures dropped to 130 in 1985. The main challenges for credit unions at this point were meeting the competition in the marketplace, continuing taxation threats in Washington, D.C., and avoiding getting mud-spattered from the efforts of S&Ls to get out of the economic mire.

For S&Ls, things seemed to be looking up. The profitability of savings and loans and banks was improving with the resumption of economic growth.

Aside from legislative deregulation, the Federal Home Loan Bank Board relaxed some of its regulatory measures to give ailing thrifts more time to overcome their problems. Among

[140] Sebastian, Bucky, Interview, April 1, 2011.

these was crediting S&L balance sheets with "regulatory goodwill" that made it possible for FSLIC, the federal S&L insurance fund, to merge two weak thrifts into one larger S&L that appeared to be healthy.

The industry seemed to be earning its way out of trouble. FSLIC closed 241 institutions in 1982, 67 in 1983 and just 35 in 1984.[141] "It appeared that, through new laws, regulations, and some good economic luck, a disaster had been averted," writes public policy analyst Mark Carl Rom.[142]

However, serious weaknesses remained. "The idea of growing out of their problems was seductive to many S&Ls. The amount of growth required, however, was enormous," writes William Black. "The solution was to grow rapidly by investing in much higher-yield (and higher-risk) assets." [143]

The industry was ballooning in assets through brokered deposits and wide-ranging investments in the regional real estate booms that had been triggered under the Tax Reform Act of 1981. The S&L growth was especially high in Texas and California, where, as previously noted, many mutuals were converting to stock institutions.

Some of the fastest growing S&Ls resorted to fraud. This was what Black calls "control fraud," in which top management was implicated and tried to hide the fraud, making it difficult for examiners, particularly the inexperienced staff of the Federal Home Loan Bank Board, to detect until some event triggered the collapse of the enterprise.

In 1983, a new chairman came on board at the Federal Home Loan Bank Board that regulated thrifts. S&L public relations man Edwin Gray arrived in Washington like Callahan as a deregulator. But events were showing that S&Ls were not

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[141] Barth, James R., Carl D.Hudson, and John S. Jahera, Jr., "S&L Closures and Survivors," in *The Causes and Costs of Depository Institution Failures*, edited by Cottrell, Allin F., et al, Kluwer Academic Publishers, 1995.

[142] Rom, Mark Carl, *Public Spirit in the Thrift Tragedy*, University of Pittsburgh Press, 1996, p. 48.

[143] Black, William K., *The Best Way to Rob a Bank Is to Own One*, University of Texas Press, p. 47.

credit unions, and Gray was progressively persuaded to become a re-regulator.

Gray's inclinations in this effort were given additional point by the fall of Empire Savings and Loans Association of Mesquite, Texas, a suburb of Dallas.

Empire's fall was deja vu all over again, as Yankee shortstop Yogi Berra might have said. It echoed the failure of Penn Square Bank two years earlier. Empire had ballooned on brokered deposits from $30 million in assets in 1982 to $270 million in late 1983. Many of these assets were development loans for, and direct investments in, condos along I-30 near Dallas that nobody wanted to rent. Some of these loans, Gray testified before a congressional subcommittee, were "barely worth the paper they were printed on."[144]

It appeared that a good deal of criminal behavior was involved, such as "land flips," fraudulent repeated sales that inflated valuations of properties. Other S&Ls had also been wheeling and dealing in the same area, and now the I-30 corridor was lined with thousands of concrete pads and partly completed structures open to the weather. Gray soon after called the case "one of the most reckless and fraudulent land investment schemes this agency has ever seen."[145]

The S&L insurance fund, FSLIC, had been considered adequate to meet demands upon it, standing at 1.34 percent of insured deposits in 1980, but events like Empire's collapse proved otherwise. By 1984 the fund's ratio to deposits had fallen to 0.82 percent.

A May 1985 study by Bank Board economists found that 1,288 thrifts at the end of 1984 either were technically bankrupt or had a net worth (capital) below that allowed by federal regulations. The economists reported that the federal insurance fund's reserves of $5.9 billion were "insufficient to

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[144] "Texas S&L fails with most of deposits from money brokers," New York Times News Service in Syracuse Herald-Journal, March 15, 1984.

[145] "I-30 condo land investment deals called fraudulent reckless schemes," The Paris (Texas) News, April 26.

handle even a few relatively costly liquidations or mergers at a time when troubled institutions are at record levels."[146]

By October 1985, the nation's thrift industry was on its way to making record profits—but it was the flush on the face of a fever victim. Gray warned a House Banking subcommittee that 300 thrifts, representing about 10 percent of the industry, were insolvent or would become insolvent in 1986. In addition, the Bank Board had a list of 900 other seriously troubled institutions. FSLIC reserves had sunk to $3.2 billion, and if the Bank Board shut down the insolvent S&Ls, the fund would run out of money.[147]

The problems of the industry no longer centered so much around their home mortgage loans, Gray told the subcommittee, but around bad commercial loans and risky investments, especially by state charters in the Sun Belt states. He listed S&L-financed ventures like a mushroom farm, a tire-retreading factory, and boats used to ferry gamblers to a lakeside resort.

Gray called for an injection of funds into FSLIC. Among the possible remedies, he favored a "one percent solution" similar to the refunding of the federal credit union share insurance fund, in which each thrift would contribute to FSLIC an amount equal to one percent of its insured deposits.

But it was not clear to lawmakers who should bear the cost of refunding FSLIC: the battered S&L industry or taxpayers, and Congress was slow to reach a decision.

Chapter 22

A New World of Competition

As the economy got stronger, credit union balance sheets improved, their capital levels began gradually to climb again, and it looked as if the credit union movement was on a roll.

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[146] "Deregulation: How strong is the current banking system," Newhouse News Service, in Syracuse Herald-Journal, July 8, 1985.

[147] "FSLIC Faces Funds Crisis, Gray Tells Hill," The Washington Post, October 15, 1985, p. E1.

The trade newspaper American Banker commissioned the Gallup organization to make an annual survey of consumer satisfaction with their financial institutions.[148] Credit unions always came out on top, ahead of commercial banks and savings and loans. But, as noted already, some observers wondered if credit unions were prepared to face the new world of consumer finance unleashed by legal and regulatory changes.

Edward Pyatt studied the Pennsylvania credit union movement for his doctoral thesis. In a paper published in 1985, the Hampton University, Virginia, faculty member's main concern was whether credit unions—with their small size and limited fields of membership—could muster the economies of scale necessary to compete with banks and thrifts, not to mention the 'non-bank banks' like Sears which then were entering the financial marketplace. He wrote:

"In 1985 the average credit union had 2,900 members, deposits of $7 million and assets of under $8 million. By any measure these figures identify credit unions as being small compared to banks and S&Ls. One bank, Citibank, with assets of $176 billion, has more assets than all of the credit unions in the U. S. combined.

"Given their small size the deregulation of financial institutions has important implications for credit unions. The pessimistic view is that deregulation has signaled the beginning of the end of the credit union industry."

In summary, Pyatt saw "a bleak picture for credit unions. Their size and the structure of the industry will make it difficult or impossible for them to realize the economies of scale inherent in their operations and also make it difficult for them

[148] Begun in 1984, the survey has been criticized by bankers for not comparing institutions of similar size. Credit unions might score highest, these critics say, because they are smaller and closer to their members. However, American Banker has not changed its methodology and the survey has continued to show credit unions on top in consumer satisfaction in the decades since 1984.

to compete effectively with other financial institutions in an era of deregulation."[149]

Pyatt's concerns were shared by the credit union movement. Many of CUNA Chairman Joe Perkowski's speeches in 1985 and 1986 dealt with the competition, among them the "non-bank banks," firms offering financial services that in the past had been offered largely through depository institutions.

Some "Non-Bank Banks"

In 1977 Merrill Lynch initiated its Cash Management Account, which combined stock brokerage with savings and checking accounts. "The bank of the future already exists, and it's called Merrill Lynch," said Walter Wriston, former Citicorp chairman, in a 1984 Time Magazine cover story.

The Prudential insurance company purchased the Bache investment and brokerage house in 1981. Prudential-Bache could sell insurance, money market funds, tax shelters, real estate partnerships, and stocks and bonds.

Sears, the largest retailer in the United States, purchased the Dean Witter Reynolds brokerage organization and the real-estate firm of Coldwell Banker in 1981, in an attempt to add financial services to its portfolio of customer products. In other words, consumers could buy both "socks and stocks" from Sears.

In 1985, Sears introduced the Discover credit card to compete with Visa, MasterCard, and American Express. The Discover Card gained a large national consumer base by carrying no annual fee, which was uncommon at the time, and offering a higher credit limit than similar cards. Cardholders could earn a "Cashback Bonus," in which 2 percent of the amount spent would be refunded to the account, depending on how much the card was used.

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[149] Pyatt, Edward J., *Economies of Scale in Credit Unions: Some Implications in an Era of Deregulation*, Hampton University, 1985, p. 5.

Chapter 23

Car Wars

"Auto Makers Launch Interest-Rate War," declared the August 22, 1985, headline in The Washington Post.

"The nation's Big Three auto makers, in an effort to reduce bulging inventories of 1985 cars, have begun an interest-rate war that could give new-car buyers some of the best financing terms since the recession of 1983," the article reported.[150]

The immediate trigger for this phenomenon was a 26-day Teamsters Union strike that had held up delivery of a month's production of 1985 models to dealers. The cars began to arrive at dealers shortly before the 1986 model year was to begin in October.

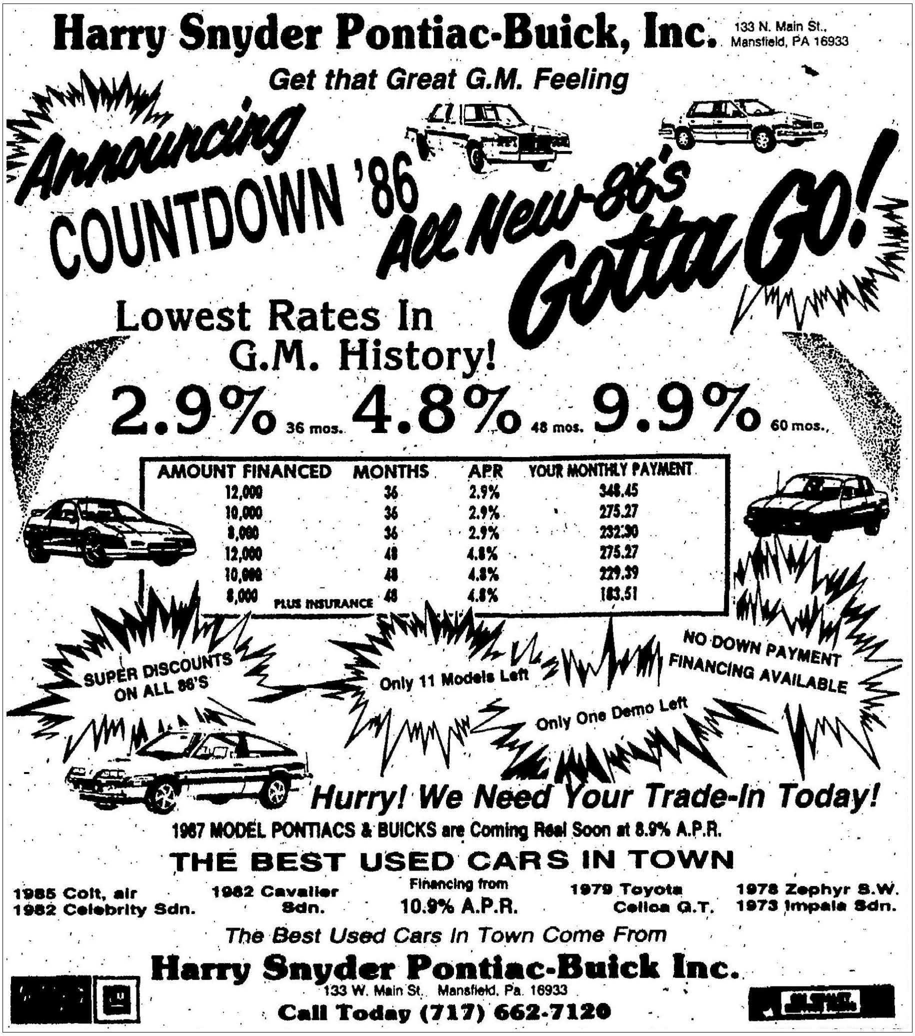
"Right now, there are too many cars," said Chuck Clifford, owner of Clifford Chrysler Plymouth Inc. in Libertyville, Illinois. "This is being done to clear inventory. We want to be in a position to go into the 1986 line with no carry-over. We'd rather give them to customers than keep the cars."[151]

The automakers offered new car buyers the alternative of rebates on cash purchases or below-market rates on financing through their captive finance companies: General Motors Acceptance Corporation (GMAC), Ford Motor Credit Company, and Chrysler Financial Corporation. The interest rates the captives offered were below their cost of funds, the difference being made up by the parent auto makers.

Vehicle loans had been a major activity for credit unions since the 1920s. They comprised some 40 percent of the credit union loan portfolio in the mid-1980s. But now the aggressive tactics of the captive auto finance companies threatened credit unions' place in the market.

[150] "Auto Makers Launch Interest-Rate War," The Washington Post, August 22, 1985, p. D1.

[151] "Car wars erupt in suburbs as dealers unload 1985 glut," Daily Herald, Arlington Heights, Ill, August 22, 1985, section 1-5.



Dealer discounts erupting in 1985 proved to be a tough challenge for credit union lending.

General Motors had pioneered the concept of a financial affiliate in 1919 at a time when banks considered cars to be sporting and recreational vehicles and often refused credit to buy them. (As the credit union movement spread during the 1920s, there was considerable debate among the pioneers as to whether automobiles were a luxury or a "provident purpose"

worthy of a loan. Obviously, the balance eventually tilted toward the provident purpose school.)

Because of the reluctance of lenders in those early days, most motorists had to pay cash for their autos. Since the least expensive GM model in 1919 was the Chevrolet 490 roadster at $715, and the average person's annual income was $605, this was an obvious barrier to buyers. While there were some independent auto finance companies, GMAC was the first owned by an automaker. It helped both dealers and individuals finance their GM purchases and contributed toward creating a mass market for the company's products. GM's rivals took a long time to follow suit. Ford Motor Credit Co. was established in 1959; Chrysler Credit Corp. followed five years later.[152]

Consumer Reports editors surveyed 100 banks and savings and loans in 10 major cities in the summer of 1985. Interest rates on a $7,500 fixed-rate new-car loan were generally in the 12.5 percent to 14.5 percent range.[153]

Credit union rates averaged in the lower part of that range.[154] In contrast, some auto finance companies were offering 7.5 percent loans to buyers of certain cars.Although the automakers vowed that the special deals were temporary, dealers were still faced with a glut of 1986 models as the 1987 model year approached. Once again the car wars erupted, this time with interest rates ranging down to zero percent.

The rebates and lower interest rates worked, even though they were available only on certain models of cars. Buyers swarmed dealer lots. "It has just been overwhelming," said Keith Pierce, a salesman at Van's Chevrolet in Overland Park, Kansas. "It's like the new cars have come out, with everybody on the showroom floor."

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[152] "Financing pioneer put more people in new cars," Automotive News, September 14, 2008.

[153] "Car payments are spreading," by The Editors of Consumer Reports, The Gettysburg (Pennsylvania) Times, November 23, 1985, p. 7.

[154] Credit union figures taken from table in 1995 Credit Union Report published by CUNA.

"It's been pretty amazing," said Gary Pratt, new car manager for Bill DeFouw Chevrolet-BMW in Lafayette, Indiana. "We sold 30 cars yesterday. That's more than twice our normal volume."[155]

Credit unions and banks found it difficult or impossible to match those rates. And credit unions found it hard to explain to members why the low rates were not necessarily a great deal.

George Ballis, manager of Amoco Federal Credit Union, Galveston, Texas, advised members of his credit union to take the cash rebate and finance through the credit union at 9.9 percent, getting the best of both worlds. The advertised dealer low rates were "only a gimmick and it's not pro-consumer," he told a reporter.[156]

CUNA president Jim Williams called the rates "hype" that was "killing the loan portfolios of many credit unions."[157] The auto loan share of the credit union loan portfolio began to decline.

This struggle would continue in the coming years, with credit unions adopting a variety of strategies for competing in this marketing warfare:

- Reducing loan rates to as low as possible.
- Like CEO Ballis, urging members to get pre-approval of a loan from their credit union before shopping so they could pay cash for the car and get the promised rebate. They were shown how this would save them money overall.
- Working with dealers to offer their own car discount programs.

On the national level, CUNA provided its member leagues and their affiliated credit unions with information on

[155] "Low rates escalate into car wars," Associated Press, Santa Fe New Mexican, August 30, 1986, p. A-1.

[156] "2.9 percent: big break for consumer?," The Galveston Daily News, September 14, 1986, p. 1-B.

[157] Williams, Jim, President's Report to CUNA Board of Directors, October, 1986.

competitive strategies and with literature to distribute to credit union members.[158] CUNA also took up the issue with the Federal Trade Commission and the Federal Reserve, arguing that auto makers might be boosting prices on cars to make up for the discount programs. This would have violated the Truth in Lending law. The two agencies replied that they could not find evidence that this was happening.[159]

Competition from these auto loan "subvention" programs, as the subsidized loan rates were called, would continue in coming decades because the automotive companies found that they "moved metal." As one research report put it in 2005: "Incentivised financing in the automotive industry has played an enormous role in vehicle sales. . . . (These programs) have had a great influence in luring buyers to showrooms."[160]

Credit unions, however, would manage to maintain a sturdy foothold in the car financing market, and mortgage financing would help replace the declines in their auto loan portfolio.

Chapter 24

Cooperation the Answer

CUNA's response to the car loan interest rate war was one example of how the movement was dealing with competitive challenges.

A larger credit union with significant resources and skilled personnel might adapt successfully to intense competition. But smaller credit unions often lacked the financial and human capital to deal with the market on their own. There had to be some way of communicating successful strategies to the movement as a whole.

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[158] See the following chapter for information on CUNA-league relations.

[159] "Credit Unions Still Fighting for Market Share," Credit Union Magazine, June 1986, pp. 18-24.

[160] Watanabe, Marguerite, "Impact of Auto Financing on Financial Services," Benchmark Consulting International NA, Inc., 2005.

Credit unionists also needed training of various kinds to meet the challenges facing managers and volunteers in the 1980s.

And only the movement as a whole had the resources to survey, identify, and meet the full array of challenges, from the Discover Card to proposals in Congress to tax credit unions.

In short, only through cooperation could credit unions hope to compete successfully in the modern marketplace. That meant sharing of information, ideas, and resources. The major channels for this cooperation were local credit union chapters, state leagues, and the national organizations, especially the Credit Union National Association.

Let's look at the local and state levels first, then the national.

Credit unions affiliated through their state league with CUNA were organized into chapters on the local level. Typically, each chapter met monthly for a meal, a program, and discussion of common problems, whether marketing, technological or legislative.

On the state level, most credit unions belonged to a league affiliated with CUNA.[161] The leagues and CUNA had not waited until the 1980s to employ the principle of cooperation among cooperatives. They had a long history of giving credit unions a voice in state and federal government and providing support to individual credit unions. But their role was changing as the movement evolved.

Leagues traditionally had focused on dues-supported activities. One of their roles had been organizing new credit unions and helping existing credit unions with such tasks as bookkeeping and legal advice. However, as NCUA made it more difficult to organize new credit unions and existing credit unions became larger and more sophisticated, the league role evolved toward providing support for the expanded services and products offered by credit unions. This made it possible

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161 There were a few states where leagues rival to the CUNA league existed, as in Massachusetts.

for even small credit unions to broaden their offerings.

By the 1980s:

● The typical state league offered its members traditional association services like publications, educational opportunities, advocacy in state government, and legal and operational advice. Membership dues largely supported these services, although training opportunities would carry a fee.

● The league service corporation, or LSC, organized as a separate entity to protect the tax exempt status of the league, offered a variety of services for a fee to member credit unions. Those included credit card and share draft processing, printing and forms, data processing, and the like. Leagues were becoming more dependent on this income from fee-supported services.

● And a corporate credit union, operating as a "banker's bank," offered a place for its member credit unions to invest their surplus cash and to borrow when funds for lending were tight. Corporates also provided their members with share draft clearing and settlement, automated clearinghouse processing, and other services.[162]

Each of these entities had its own board elected by its member credit unions, which hired management. One question that faced these organizations in each state was how tightly their operations should be integrated. It was generally held that close integration was the best option, avoiding conflicts in operations and providing some economies of scale in that they could share overhead functions like facilities, purchasing, human resources, and data processing.

Thus, more than half the leagues, their service corporations, and their corporates had overlapping boards of directors (and in some cases, boards consisting of exactly the same individuals), along with a single chief executive, the league president.

Brad Murphy, long active in league and CUNA affairs, said

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[162] In the 1980s, most states had their own corporates, but there has been considerable consolidation since.

he could think of dozens of examples where integration helped —not the least of which was in Georgia, where he managed the league from 1982 to 1985. Lack of integration was tearing them apart, he recalled. They were fighting each other, and when they decided to integrate, they were able to be much more effective.[163]

Each of the leagues had a hired president, and an elected chairman. (There were few women in league leadership roles at the time; the same held true of CUNA.) League executives had their own organization, the Association of Credit Union League Executives (ACULE) which was a forum for discussion about common problems and also provided training and other services to leagues.

ACULE provided a platform for league executives to make their views known to the national organizations and thus played an important role in internal credit union movement politics. Some felt it spent too much of its time and energies in politicking, but as time passed, it took on more substantive roles and made valuable contributions to the organized movement.

Chapter 25

The National Level

CUNA had a similar tri-partite structure capping the league structure. CUNA itself was the trade association that worked through the leagues. Its affiliated CUNA Service Group worked through the league service corporations, and its other affiliate, U.S. Central Credit Union, acted as a central bank for its member corporate credit unions. [164]

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[163] Murphy, Brad, Interview, June 25, 2001, CUNA Information Resource Center Archive.

[164] CUNA Mutual Group, which provides insurance of various kinds to credit unions and their members, began as an affiliate of CUNA but is independently governed by its policyholder credit unions. For many credit unions, CUNA Mutual has been their main contact with the national level, not CUNA itself. CUNA Mutual provides considerable financial support for CUNA activities.

CUNA, like many of its leagues, was integrated. Since 1979, Jim Williams had served as president of all three national organizations, and they had overlapping boards of directors. CUNA adopted the term “the Credit Union Financial and Support System” to refer to the credit union-league-CUNA structure. CUNA and its associated companies were called CUNA and Affiliates. It was governed democratically through a complex election system at the league, regional and national level that selected various CUNA and Affiliates boards, executive committees, and the CUNA chairman and board officers (referred to in credit union parlance as “table officers”).

A theme of many speeches by CUNA leadership was cooperation and unity. This was to counter the strains that beset any national organization. There were inevitably tensions between CUNA and its member leagues, with the leagues acting as gatekeepers between CUNA and their member credit unions. Leagues were free to use or not use national programs and products as they chose, and could turn to alternative suppliers outside the Credit Union System or set up their own programs in competition with CUNA.

Each league faced the same strains within its own bailiwick, with credit unions free to join or not, and if they joined, free to use or not use league programs and products. There were also tensions between large and small credit unions, with each seeking league and CUNA attention to its own needs. And similar tensions existed between federally chartered credit unions and state-chartered credit unions.

As noted earlier, some of the larger federally chartered credit unions, many of them military-related credit unions, had formed their own national organization outside this structure, the National Association of Federal Credit Unions (NAFCU), headquartered in Washington, D.C. NAFCU members, however, often also belonged to their state league and thus were affiliated with CUNA. All together, just over 90 percent of the nation’s credit unions were affiliated with CUNA through the leagues. And because it had much larger resources in money and staff than NAFCU, it played a preponderant role in the movement.

The larger and medium-sized credit unions tended to be more active in CUNA because they had the staff back up to permit their executives to volunteer on the national level. But the managers of the largest credit unions often became frustrated with the complex CUNA election system that required an individual to spend years climbing the elective ladder to reach a position where he or she could exert real influence on the movement. They liked the input offered by NAFCU, to which they belonged directly and which had a much simpler electoral structure.

By the 1980s, the larger credit unions had the size and clout to exert pressure, if they chose to do so, by threatening to leave their league and thus CUNA.

This tactic was not common, but to lose a large member was serious business for a league, especially a small league, and for CUNA, as well. Among other things, it meant a significant loss of dues and income from products and services sold to the credit union through the league. To help foster a good relationship with larger credit unions, CUNA in 1983 instituted the annual National Credit Union Roundtable, a meeting of the CEOs of the nation's largest credit unions.

When the Roundtable was created there was a firm recognition that unless the energy and the involvement of these very large credit union CEO's was harnessed and working in concert with the leagues and national association, CUNA was going to have trouble, remembered Brad Murphy.[165]

Another problem for the Credit Union System was that larger credit unions were increasingly less dependent on the leagues and CUNA for services and products. They had the buying power to attract outside vendors for such services as share draft and credit card processing. And those vendors could "cherry pick" credit unions, offering advantageous prices to big credit unions and ignoring the needs of small ones.

So for both national and state leaders, much of their job consisted of balancing the diverse interests of the movement.

[165] Murphy, Brad, Interview, CUNA Information Resource Center Archive, June 25, 2001,

On the most serious issues, however, such as important legislation, the movement tended to pull together, aware of Ben Franklin's warning to the signers of the Declaration of Independence: "We must all hang together or assuredly we shall all hang separately."

As economist Douglas Pearce summed it up: "The dominant role of CUNA and its subsidiaries makes the credit union industry resemble in some respects one large financial entity. The individual credit unions collect deposits and originate loans. They buy their office supplies, computer services, and investment advice within the industry. Funds in excess of loans can be funneled into one pool to be managed by professionals or loaned to other credit unions. Thus, in analyzing the competitiveness of credit unions relative to other depository institutions, it may be more realistic to view the credit union industry as one financial network with thousands of branches rather than thousands of small intermediaries."[166]

Another increasingly important channel for credit union cooperation was the Credit Union Service Organization, or CUSO, a cooperative venture formed by one or more credit unions and/or leagues to provide services to credit union members or to the credit unions themselves.

By 1985, 509 CUSOs were operating on behalf of 17,311 credit unions.[167] Those aimed at serving individual credit union members provided services like insurance, financial planning, tax preparation, mortgage banking, and travel services. Those serving credit unions provided data processing, printing, credit card and share draft processing, and other back-office services. Some operated shared service centers where members of several credit unions could make deposits, cash share drafts, and make loan payments at one location.

CUSOs were not a panacea. The products and services

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[166] Pearce, Douglas, "Recent Developments in the Credit Union Industry," Federal Reserve Bank of Kansas City Economic Review, June 1984, p. 12.

[167] "CUSOs formed for three reasons," Credit Union Magazine, July, 1986, p. 42.

they offered had to be first class or risk the reputation of the participating credit unions. Some turned out to be money losers. One credit union got into real estate development through a CUSO and suffered substantial losses.[168] However, on the whole, they provided a valuable way to extend credit union services.

Chapter 26

Technological Advances

As noted earlier, computers and electronic funds transfers were changing both front-line and back-office operations, making for faster and more accurate handling of accounts. They were also making it possible to serve larger numbers of members, and thus enabled credit unions to grow their fields of membership as field of membership restrictions were relaxed. Credit union employees who were used to the old ways of doing things often greeted these advances with trepidation, but with proper training, the new equipment eased their work and increased productivity.

Lisa Coates, lending sales specialist at CUNA Mutual Group, recalled: "I was a loan officer at a Santa Clara, California, credit union in the 1980's. It had to be somewhere between 1983 and 1988 when the credit union got a fax machine. We loan officers were so excited that we could now have (car) dealers fax over the member purchase orders! (I'm betting we then took applications and got paycheck stubs later too, but it's the dealer's vehicle purchase orders that really stand out.) How quickly we'd turn a car loan around now! It was such a big deal. Of course it was that curled-up, thermal paper that would fade over time; but holy cow we thought we were so cutting edge!"[169]

The larger credit unions usually led the way, while the leagues and CUNA Service Group provided support services

[168] Gordon, Daniel, "Credit Union Service Organizations," NCUA Research Study No. 6, March, 1988.

[169] Coates, Lisa, E-mail to author, February 7, 2011.

that enabled smaller credit unions to get on board.

Share accounting was one area where computers were greatly improving employee productivity. The switch to computers from manual or machine posting began as early as the 1960s. For example, Dupaco Community Credit Union in Dubuque, Iowa, was one of the first credit unions in the nation to install a computer bookkeeping system in 1964, eliminating passbooks.

By the 1980s, many small credit unions still did share accounting by hand or by machine posting. But among larger credit unions, this was usually done either on a minicomputer (a desk-sized computer with "dumb terminals") or on personal computers that were rapidly gaining in power and declining in price. Some credit unions were linked by telephone line (broadband did not exist for the general public) to league service bureaus or other providers that did share accounting "on-line" as transactions occurred or in batches.

Automation made it easier to add new services such as share drafts, credit cards, IRAs, home equity lines of credit, and the like.

As automation progressed, the joke was that soon financial institutions would have just two employees—a man and a dog. The man would be there to feed the dog, and the dog would be there to make sure the man didn't touch the equipment.[170]

Some credit union leaders saw in automation and telecommunication an opportunity to tie the movement even more closely together. In the early 1980s, CUNA President Jim Williams launched an ambitious project to link the entire U.S. movement by computer. Williams was ideally suited to leading such a project. He had extensive experience managing credit unions in Texas and had been a pioneer in adopting modern technology at Government Employees Credit Union in San Antonio.

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[170] Joke cited by Linda L. Baughman, University and State Employees Federal Credit Union, San Diego, California, in remarks at a Filene Institute Colloquium on "Consolidation of the Financial Services Industry, 1999."

A Typical Timeline for Automation

(Adapted from "An In-Depth Timeline" of Hutchinson Credit Union, Hutchinson, Kansas.)

1948

Credit Union founded. Hutchinson teachers allowed membership only. (Other groups added later.)
Strictly a place to save and/or borrow.
The credit union continued in this mode for over 20 years.

1966 through 1974

Technology started taking over!
Accounts were listed in numerical order rather than alpha.
What an improvement—faster, greater accuracy—fantastic!
Posting machine purchased, all account records kept on ledger cards. No more hand posting!

1975 through 1980

"Batch" data processing with Farmland Industries was started. This was a major step forward.

1980

On-line data processing with CUNA Data.
Equipment added: CRT's (computer terminals linked to main computer), printers, check writer, coin counter, currency counter, safe deposit boxes, rotary color coded file system, microfilmer, reader and printer, document shredder, memory typewriters.

1985

Several personal computers (IBM 8088 PCs) added.

1987

Fax machine at main branch—a revolution!

1989

Check encoder, more terminals added, additional staff added, deposits sent daily to Federal Reserve.

Williams had served as CUNA chairman before being tapped for the position as president. He was hired on his

experience as a manager to straighten out management and financial problems at CUNA.

While he could point to a number of successes, Williams never won the wholehearted support of the leagues. And by 1985, his project to link the Credit Union System through a computer network that was dubbed the Credit Union Internet was not winning the participation of leagues and credit unions and was running a deficit of some $2.3 million.[171]

Williams resigned in 1986. The part of the computer project that would survive his administration was the Corporate Credit Union Network (CCUN), the joint data processing system used by U.S. Central Credit Union and its member corporates. In a few years, his larger dream would be realized through the growth of the "real" Internet and the invention of the World Wide Web that would electronically link the entire nation (and with it the credit union movement) together.

Chapter 27

S&Ls Begin Eroding Private Insurance

> 11.00% ANNUAL INTEREST. 11.41% ANNUAL YIELD. GUARANTEED FOR 3 YEARS. There's just no excuse for lazy investing. Not with great rates like these... All guaranteed by the Ohio Deposit Guaranty Fund (ODGF) with no restriction on the amount insured. So if you're not earning rates like these, get moving.

So read the advertisement in the January 11, 1984, edition of the Marysville, Ohio Journal-Tribune. The advertiser, City Savings and Loan, like 69 other Ohio state-chartered S&Ls, was privately insured. However, in a little over a year, the thrift would find itself thrust into the arms of the federal thrift insurance fund, FSLIC, not through any actions of its own, but by a chain of events started by another thrift in Cincinnati.

[171] What became known in the 1990s as "the" Internet evolved from ARPANET, a network connecting the Defense Department's Advanced Research Projects Agency (ARPA) with universities.

Eventually, this chain of events would also stir turmoil in the credit union world.

It all started in early March, 1985, when a long line of people formed in fog and light rain outside the doors of Cincinnati's Home State Savings Bank, assets $1.4 billion. They had read or heard on the news that Home State had lost heavily in the collapse of a Florida securities firm a few days before, and they wanted their money out—now. It was a classic run like that portrayed in the film "A Wonderful Life," but the S&L's president, Marvin Warner, was no Jimmy Stewart. He eventually would serve 28 months in prison for various illegal acts.

Home State had no line of credit set up with the Federal Home Loan Bank, and it had no quick way to obtain cash to meet depositor demands. After withdrawals of some $90 million, state regulators stepped in and closed the thrift.

Depositors may have assumed they were protected by the Ohio Deposit Guaranty Fund, of which Home State was the largest member, but the fact was, the $136 million fund simply didn't have enough reserves to cover Home State's losses. The state legislature hurriedly appropriated $90 million to supplement the fund. But that didn't stop nervous depositors from starting runs on the 69 other state-chartered thrifts "protected" by ODGF.

Faced with block-long lines and depositors sleeping on sidewalks through the night, Governor Richard Celeste on March 15 ordered all 70 institutions closed temporarily, a "bank holiday" that would give the state time to sort out the mess. Most of the thrifts, including City Savings and Loan, whose ad is featured above, converted to federal S&L insurance and were allowed to reopen. Ohio liquidated Home State and three other thrifts. Eventually, all depositors were made whole.

A few weeks after the run on Ohio's Home Savings, on May 9, 1985, another long line of anxious depositors stretched down the block, but now they were waiting outside Old Court Savings and Loan in Baltimore County, Maryland. Old Court was the state's third largest S&L, with assets of more than

$800 million. State residents had learned that the Maryland Savings Share Insurance Corporation (MSSIC) had forced a change in management at Old Court, and that the thrift had engaged in possibly illegal activities.

The first day of the run, customers withdrew $12.8 million. That was a Thursday. The state went into court over the weekend and got the thrift put under the conservatorship of the insurance fund, MSSIC. Another thrift, Merritt Commercial Savings and Loan of Baltimore also found its depositors demanding their money. The depositors were concerned over an office tower Merritt was building that had no tenants signed up. The thrift asked to be placed in conservatorship as well. The two thrifts were permitted to reopen, but depositors could only withdraw $1,000 per month.

Eventually, the state limited withdrawals at more than 100 state-chartered thrifts to $1,000 per person per month. Depositors learned that the private thrift insurance was inadequate to the demands on it, and that they had been wrong to believe, as many did, that the state government backed it.

The Maryland legislature enacted a series of measures to deal with the situation and get the state-chartered S&Ls switched to federal insurance. But as the Christmas season approached, many depositors still did not have access to their money. State and federal examiners found some of the privately insured thrifts were too weak to get federal insurance, and those institutions were closed. The state came up with money to supplement MSSIC's reserves. Eventually, the affair cost the now-defunct insurance fund and the state some $185 million.

The shift to federal insurance by S&Ls was putting additional strains on the already over-burdened federal thrift fund, FSLIC. As banking expert Bert Ely told a meeting of the National Association of State Credit Union Supervisors (NASCUS) in September 1985: "In what must be one of 1985's greatest ironies, privately insured S&Ls are flocking towards, or are being pushed into, a FSLIC that itself is careening

toward bankruptcy, a taxpayer-financed bailout its only salvation."[172]

Chapter 28

Credit Union Private Insurance Imperiled

Credit unions could not stand apart from these events. Forty percent of the nation's 7,544 state chartered credit unions were backed by one of 18 private insurers. Thirty-eight states had private credit union insurance available. Most insurers covered only credit unions; a few also insured savings and loans and savings banks.

Until the recapitalization of the federal share insurance fund, the state funds in aggregate had been better capitalized than NCUSIF. But now federal insurance looked like the better bet compared to some private credit union funds, especially those that also insured S&Ls. How would the public and lawmakers react in light of the problems of S&L insurers?

The American Banker reported that federally insured credit unions in Maryland and Ohio were benefiting from the S&L insurance problems in their states with an inflow of deposits. One of them was the National Institutes of Health Credit Union in Bethesda, Maryland, which saw a "guesstimated" $1-1.5 million jump in deposits.[173]

In contrast, privately insured credit unions in Maryland, while their members remained largely loyal, saw no increase in deposits, and many applied for federal insurance. At State Employees Credit Union of Maryland, Inc., one of the state's largest, General Manager George Reichenberg said that the credit union had seen no significant loss of deposits and was "holding its own," but that it was applying for federal insurance.[174]

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[172] Ely, Bert, "Private Deposit Insurance—The Next Chapter," Speech to the National Association of State Credit Union Supervisors, September 24, 1985.

[173] "Thrift Troubles Cause Increase in Deposits at Credit Unions," The American Banker, June 25, 1985.

[174] Ibid.

Other credit unions in Maryland and around the country, however, stuck with private insurance. Among them was Cincinnati Central Credit Union, whose manager was Bill Herring, son of Ohio credit union pioneer Louise Herring.

Bill Herring was an official of Ohio's multi-state credit union insurer National Deposit Guaranty Corporation (NDGC), known today as American Share Insurance. Although Ohio was one focus of the S&L private insurance crisis, he reported that he had "lots of phone calls and questions from members, but no closed accounts."[175] To this day, he argues that much of the private share insurance industry was sound despite the publicized problems.

NDGC put together a public relations program to reassure its members that the fund did not insure any S&Ls and that it was sound, recalled Dennis Adams, who had recently been hired by the fund and would become its president. The firm arranged a series of meetings with its credit union members at which representatives of the Federal Reserve and the corporate system urged credit unions to take a lesson from the S&L failures and make sure they had enough liquidity and lines of credit to meet unexpected demands.[176] NDGC retained the faith of its members and the state government.

But in a number of states, governors and lawmakers considered doing away with all private insurance. In Maryland, the credit union league and CUNA successfully fought proposals to shut down the private credit union share insurance fund. It was often a different story elsewhere.

In Wisconsin, nearly all credit unions—516—were state chartered, and some were privately insured. In July 1985, the legislature passed a bill that was signed by Governor Tony Earl

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[175] Ibid.

[176] Adams, Dennis, Interview, August 25, 2011. NDGC is now known as American Share Insurance. Adams, a Certified Public Accountant and Certified Financial Planner, is President and CEO, a position he has held since November, 1990. Previously he served as the firm's Vice President of Risk Management and Chief Financial Officer from 1986 to 1990.

requiring all the state's credit unions to become federally insured within 42 months.

In North Carolina, the Financial Institutions Assurance Corporation told the 25 credit unions and 31 savings and loans it insured to apply for federal insurance.

In Massachusetts, at the encouragement of the state banking commissioner, privately insured credit unions, cooperative banks, and savings banks began switching to federal insurance. Eventually, the Massachusetts Credit Union Share Insurance Corporation converted to being solely an excess deposit insurer. As an excess insurer, MSIC now insures deposits above $250,000 in 100 state and federally chartered credit unions across Massachusetts.

Much of the credit union movement saw private insurance as essential to maintenance of the dual chartering system, in which state-chartered credit unions were supervised by state regulators. The movement considered states fountainheads of innovation in such areas as corporate credit unions, deregulation, and the "One Percent Solution" to recapitalizing the federal fund.

"(He) who insures regulates," as Bert Ely told the National Association of State Credit Union Supervisors (NASCUS).[177] "Increasingly, the regulator who insures, or who supervises the insurer, is the predominant, de facto, regulator of the insured depository . . . .If NASCUS members want to continue as the principal regulators of state-chartered credit unions, they need to work hard to preserve some form of non-federal share insurance for their credit unions."

NCUA defended private share insurance, as did CUNA and the Association of Credit Union League Executives (ACULE). NCUA Chairman Roger Jepsen told The American Banker trade newspaper: "We think people should be encouraged that there are privately insured credit unions."[178]

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[177] Ely, Bert, "Private Deposit Insurance – The Next Chapter," Speech to the National Association of State Credit Union Supervisors, Kiawah Island, South Carolina, September 24, 1985.

But behind the scenes, NCUA, CUNA and the leagues were worried that the private credit union share insurance system was vulnerable if one or more large credit unions or other insured large institutions went under. Ohio's multi-state credit union insurance fund carried reinsurance that protected it in case demands exceeded its reserves. Others, however, lacked such backup,

In late 1986, in the midst of this turmoil, Ralph Swoboda became CUNA's president and soon was involved in dealing with the private funds.

Swoboda had spent most of his years at CUNA as legal counsel but had been asked to run an ailing CUNA Service Group by CUNA President Jim Williams. Swoboda had turned it around financially. After William's departure, the CUNA board selected Swoboda to succeed him.

While Williams was a "nuts and bolts" person interested in operational details, Swoboda was an "idea" person with an analytical mind and wide-ranging interests.

The man in charge of CUNA's Washington office, the senior vice president of governmental affairs, Karl Hoyle, had a good relationship with Jim Williams, whom he later characterized as one of the best bosses he ever had. When Jim Williams left CUNA, Hoyle left too, not out of pique, he said, but because he wanted to give Ralph the opportunity to have his own people. [179]

Illustrating the close-knit world of Washington insiders, Hoyle was a friend of Danny Wall, then head of the Federal Home Loan Bank Board. Wall offered him a position as executive director for external affairs at the board, handling government relations and public relations for the S&L regulatory agency. Hoyle saw it as a challenge to try and solve the industry's growing crisis.

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[178] "Private Insurance Supported," Credit Union Newswatch, July 1, 1985, p. 1.

[179] Hoyle, Karl, Interview, March 17, 2005, CUNA Information Resource Center Archive.

On Hoyle's recommendation, Jim Williams was hired as deputy director in charge of case resolution at the Board. His job was to take in savings and loans throughout the nation and liquidate or sell them. He would be busy.

To replace Hoyle at the Washington Office, Swoboda chose Charles O. (Chuck) Zuver, who had been chief lobbyist for the American Bankers Association but who had become dissatisfied with his position.[180]

One of Swoboda's first tasks as president was dealing with the private insurance issue.

"If you looked at the ratio of their funds to the amount of risk that they were insuring, the ratios were actually better than National Credit Union Share Insurance Fund," he noted.[181] The peril lay in the "tall trees"—the relatively few but very large credit unions like United Airlines Credit Union whose failure would deplete the funds of their private insurer.

"I led a secret effort by CUNA, with assistance from ACULE (Association of Credit Union League Executives) to convince the private insurers that their only salvation would be some kind of amalgamation or mutual cross-guarantee arrangement, whereby they could spread the risk of a single large credit union failure across the assets of all the private insurers," he recalled.[182]

"We had three or four meetings with representatives of all the private insurers, and Dennis Adams from the (then) National Deposit Guaranty Corporation played a very constructive and leading role. But at the end of it all, nothing could be agreed.

"Ironically, (in the light of later events), the effort failed primarily because of objections from RISDIC (Rhode Island Share and Deposit Indemnity Corporation) representatives,

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[180] Zuver kept a plaque over his desk at CUNA Washington: "Please don't tell my mother I'm a lobbyist. She thinks I'm a piano player in a whorehouse."

[181] Swoboda, Ralph, Interview, February 4, 2010.

[182] Swoboda, Ralph, private communication with author, November 24, 2004.

who were adamant that their fund not share in losses at other state funds, which in RISDIC's view were not nearly so well managed and strong as they were!"

Dennis Adams agreed with this account, but saw a more fundamental stumbling block preventing the private insurance funds from sharing risks. "The reason they couldn't amalgamate under one roof was that each of these corporates was chartered in its own respective state, and each charter had its own limitations. . . . So the laws that governed the corporations prohibited the amalgamation that CUNA thought would be a favorable solution in the long run."[183]

Swoboda, however, felt that the share insurance corporations used the legal argument to avoid doing what they basically did not want to do—join forces to strengthen private insurance. "They could have gotten the laws changed—and I think they had the political power to do this if they really wanted to," he said.[184]

But no matter which perspective one agreed with, the heyday of the private insurance funds would soon be over.

Chapter 29

The Rhode Island Insurance Debate

Rhode Island's private share insurance fund was founded in 1969 and initially covered only state-chartered credit unions. But it was expanded in 1976 to cover loan and investment banks, a type of institution peculiar to the state.

The Rhode Island Share and Deposit Indemnity Corporation (RISDIC—pronounced RIHZ-dik) reached its apogee in 1980 with 78 members. But its membership gradually declined over the years as state charters switched to federal insurance. The switching accelerated after the private insurance difficulties in Ohio and Maryland. By early 1986,

[183] Adams, Dennis, Interview, August 25, 2011.

[184] Swoboda, Ralph, Interview. September 20, 2011.

RISDIC's membership was down to 55 institutions and would continue falling.

RISDIC in its annual reports claimed to be "the best in the nation" and the "nation's model." It launched an advertising campaign to assure its members and the general public that "our commitment to you is carved in stone."[185]

But in fact, events would show that the insurance scheme was shaky. Apart from the banks RISDIC insured, some of Rhode Island's larger RISDIC-insured credit unions were engaged in heavy commercial lending in projects like condominiums, which were much riskier than traditional consumer and home mortgage loans.

At the same time, investigations showed, state banking authorities exerted inadequate oversight of both RISDIC and its members, and RISDIC in turn was not adequately supervising its members.

The Providence-Journal newspaper in September, 1985, reported on the "serious financial condition of a large Rhode Island loan and investment company." This prompted Rhode Island's Attorney General, Arlene Violet, to authorize an inquiry headed by retired lawyer Robert Stitt to look into RISDIC's situation.[186] Stitt reported that RISDIC would probably not be able to survive the collapse of a member institution.

Violet did not make the report public. It well might have caused public panic in light of the problems in other states. But she sent copies to Governor Edward DiPrete and the state's General Treasurer.

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[185] 1985 and 1986 RISDIC annual reports. Cited by Gregorian, Vartan, in "Carved in Sand: A Report on the Collapse of the Rhode Island Share and Deposit Indemnity Corporation," March 14, 1991.

[186] Violet was a feisty former nun who obtained a law degree to better serve the poor, then left her order in 1984 to run for the office of attorney general. Violet became the nation's first female attorney general. She fought to eliminate some of the public corruption that seemed to be endemic to Rhode Island. She was defeated after one term and became a radio talk-show host. She told her story in her autobiography "Convictions," published in 1988 by Random House.

DiPrete turned the report over to the Director of the Department of Administration, who appointed an independent counsel to look into the matter. The investigator reached conclusions much like those of the Stitt Report. In a memo of February 20, 1986, he said, "major losses in any one of a number of RISDIC-insured institutions could wipe out the fund."

Some of Violet's concerns began to filter into the press, and bills were introduced into the legislature's two houses, the Senate and House of Representatives, to require RISDIC members to obtain federal insurance. Attorney General Violet and Governor DiPrete supported the legislation. But the state's credit union league and RISDIC, as well as CUNA, opposed the bills vigorously, although it isn't clear that CUNA was aware of Violet's report when it took this stand.

Credit unions and RISDIC had built a model political affairs program in Rhode Island. Credit unions operated phone banks and made campaign contributions on behalf of their allies in state elections.

The legislature, called the General Assembly, was part-time, and its members relied on other occupations for their main income. It was not surprising that some key members of the legislature had ties to the credit union movement.

Chief among them was Robert Bianchini, president of the Rhode Island Credit Union League and assistant majority leader in the General Assembly's House. Combined with the league's very active political affairs program, Bianchini's position and that of other legislators with credit union ties gave the movement great influence in the legislature.

Former State Senator John D'Amico later described the private insurance fund's lobbying power as "tremendous." Governor DiPrete felt that the credit union lobby was "the most powerful influence in the General Assembly." A former director of the state's Department of Banking Regulation said, "RISDIC is the darling of the General Assembly."[187]

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[187] Gregorian, Vartan, Carved in Sand: A Report on the Collapse of the Rhode Island Share and Deposit Indemnity Corporation, March 14, 1991.

The Senate bill went before the Corporations Committee. Senator John Correia, a director of the East Providence Credit Union, presided over the hearing on the bill—a hearing that lasted ten minutes, during which Correia said that there were no problems of solvency among Rhode Island credit unions. The bill did not make it out of committee.[188]

The House bill went to the Finance Committee. Pro-bill witnesses included Attorney General Violet and her special assistant, Robert Stitt, who had drafted the report critical of RISDIC. Violet offered to share the report with the committee in executive session, but the committee did not accept her offer. Governor DiPrete sent his special counsel, Norman Benoit, to testify in favor of the bill.

The opposition to the bill was impressive. It included Peter Nevola, president of RISDIC, who had somehow obtained portions of the Stitt Report and came armed with charts and experts to refute its findings. The opposition portrayed RISDIC as a national model of competence and efficiency, with higher reserves than the national insurance fund, and more flexible and helpful to its members.

Lawmakers heard Karl Hoyle, who at this point was still CUNA's chief lobbyist, testify that getting rid of RISDIC would "dilute the movement's initiative to solve its own problems and eventually encourage credit unions to look to the federal government for solutions."[189]

Former NCUA Board Chairman Ed Callahan testified against the bill, along with Betty Minor, president of the National Association of State Credit Union Supervisors (NASCUS).

But the ace in the hole for the RISDIC defenders was the committee's vice chairman, Robert Bianchini. He coordinated the defense of RISDIC and presided over parts of the committee's five-hour hearing on the bill. At times, he became an advocate defending RISDIC.

[188] Ibid., pp. 86-88. The following information on the hearing process was taken from this report.

[189] "R. I. Insurance Bill Dies," Credit Union Newswatch, July 7, 1986, p. 2.

The committee adjourned after five hours and took no further action.

Despite this defense of the private share insurance system, RISDIC was a house of cards, Hoyle would observe years later.[190]

In addition to working on the "tall tree" problem, CUNA and the insurers had been working for several years to develop standards of prudent management. The fast-moving events of 1985 led to adoption of the standards at the September meeting of the private insurance trade group, the International Share & Deposit Guaranty Association.

RISDIC adopted the standards but did not implement them. It will never be known if following the standards would have prevented the Rhode Island share insurance fund's collapse five years later. (See Chapter 38.)

The aftershocks of the 1985 fund failures continued as Virginia in late 1986 moved its privately insured credit unions to federal insurance and Utah followed in mid-1987. But ten private funds remained in operation.

In Congress, there was talk of requiring all credit unions to have federal deposit insurance. CUNA and NCUA opposed such measures. "I would reiterate our agency's long-standing support for the option of private insurance for state-chartered credit unions," NCUA Chairman Roger Jepsen told House Banking Committee Chairman Fernand St Germain (D-R.I.) in a letter. The idea of forced federalization of state credit union insurance went nowhere.

Chapter 30

Princes of Fraud—Hyfin Credit Union

Catch phrases like "If you've got it, flaunt it." "Greed is good," and "You can have it all." were part of the national vocabulary in the mid-1980s. Wealth was celebrated, and the

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[190] Hoyle, Karl, Interview, March 17, 2005, CUNA Information Resource Center Archive.

nation seemed to be running a fever of speculation and risk-taking.

Debt was no longer something to be avoided if at all possible—it was a way to realize your ambitions, especially if you were a corporate freebooter. The nation was riding a wave of leveraged buyouts, hostile takeovers, and giant corporate mergers, much of it financed by liberal bank terms and suddenly-respectable junk bonds. Representative Jim McDermott of Washington State would sum it up this way: "(The) whole ethic is to move quickly, get your profits, get in and get out, and nobody wants to wait around for the long run."[191]

S&Ls added to the lending boom by investing in often-dubious commercial real estate ventures and other speculative enterprises. The highest fliers tended to be entrepreneurs new to the business who sought quick riches, sometimes by fraudulent means.

The fall of Penn Square Bank in 1983 had been just a warning of things to come. The party started to end in 1986. The Tax Reform Act of 1986 removed incentives for investing in commercial real estate. The air went out of the commercial real estate bubble. "Everybody knew the day of reckoning would eventually come," the National Real Estate Investor noted. "But most developers—being the eternal optimists they tend to be—put it off until lenders and the new tax bill forced them to come to grips with severely overbuilt commercial real estate markets across the nation."

Savings and loan failures rose rapidly. Most of the largest failures resulted from what former federal S&L regulator and criminologist William Black calls "control fraud." Control fraud as he defines it is fraud committed by top management, which conceals the fraud through false accounting. "Fraudulent CEOs do not simply defeat controls; they suborn them and

[191] In "Financial Condition of the Federal Savings and Loan Insurance Corporation and Federal Deposit Insurance Corporation," Field Hearings Before the House Committee on Banking, Finance and Urban Affairs, Serial No. 101-13, San Antonio, Texas, March 10-11, 1989.

turn them into allies," Black states. "The accounting firms they hire give them a clean bill of health until final collapse reveals the deception."[192]

Control fraud was not confined to the S&L industry. The National Credit Union Administration warned credit unions about instances of credit union insider dealings that NCUA Vice-Chairman P.A. Mack called "shocking and intolerable." Board Chairman Roger Jepsen raised the topic again in his remarks at the February, 1986, CUNA Governmental Affairs Conference.[193] But no one was expecting the scandal that soon would be unfolding in Brooklyn, New York.

''I just figured there was a little bit of fraud, like every other place,'' said Marie Mitchell of West Hempstead, Long Island. ''I didn't think they'd close it down.''[194]

On that cool afternoon of April 9, 1986, she and a cluster of other members studied the "closed" sign on the door of the two-story, red brick building housing Hyfin Credit Union in Coney Island, Brooklyn, New York.

That morning, federal and state authorities had taken over the federally insured credit union after it was linked to corruption in the taxi industry. They found the credit union's management had misused member funds to enrich friends and themselves.

Hyfin, whose name, ironically, was an acronym for "Help Your Friend in Need," had 55,000 members, several thousand of whom were New York taxi drivers. The rest were mostly hospital and health care workers around the state.

Hyfin provided loans to yellow cab owners to buy medallions that entitled them to cruise the city and pick up people hailing from the sidewalk. (The medallion was an aluminum plaque bolted to the hood of each cab.) Medallions

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[192] Black, William, *The Best Way to Rob a Bank Is to Own One*, University of Texas Press, 2005, pp. xiii-xiv.

[193] Capital Events, Credit Union Magazine, July 1986, p. 19.

[194] "State Takes Over Brooklyn Credit Union," The New York Times, late East Coast edition, April 10, 1986, p. B3.

were often passed along from father to son or could be sold to others. Because a Depression Era law restricted the number of medallion cabs to 11,787, the imposed scarcity drove the price higher as the years passed. The going price in 1986 ranged from $60,000 to more than $100,000.

Over an eight-year period, the credit union's assets had swelled from a few hundred thousand dollars to some $70 million. To raise cash for loans, many of them fraudulent, certain large depositors were promised that Hyfin would conceal their financial business from authorities. Interest on their deposits would not be reported to the IRS.

For example, according to court testimony and documentary evidence, among the depositors was Jerome Cohen, who needed money for his campaign to be elected a civil judge. On June 14, 1979, he met with Edmund Lee, the new treasurer and chief executive officer of Hyfin. Lee approved and Hyfin granted a series of increasingly larger loans to Cohen over the years, starting with a $5,000 loan at 12 percent that same day and reaching a loan for $50,000 at l0 percent on January 10, 1985.

These interest rates were below the 15 to 21 percent most Hyfin members paid in this period, but Cohen's interest was waived for most of that time, saving him nearly $15,000. Lee told him that Hyfin was run "like a Swiss bank," had never been audited by the state, and did not report interest to the United States government. Cohen replied, "I didn't hear this."[195]

All the same, Cohen arranged for trust funds from settlements of suits by injured children to be deposited with Hyfin. Over time, this amounted to nearly $250,000 to the credit union for use in its management's schemes.

Cohen, who had risen to a higher judgeship in 1984, was eventually indicted, but a jury doubted the testimony of Lee, who had negotiated a plea bargain in exchange for his

[195] New York State Commission on Judicial Conduct, "In the Matter of the Proceeding Pursuant to Section 44, subdivision 4, of the Judiciary Law, in Relation to JEROME D. COHEN, a Justice of the Supreme Court, 2nd Judicial District, Kings County," October 28, 1988.

testimony, and found Cohen not guilty. However, a judicial panel removed Cohen from the bench.

The first public indication of trouble at Hyfin began in 1983 when the Fireman's Fund insurance company sued the credit union, charging that it "knowingly participated in and furthered" a $50 million a year insurance scam by processing checks to fictitious insurance policy-holders.[196]

However, state banking authorities failed to note the red flag because the credit union's attorney did not notify them of the suit, as he was required to do by regulation. In addition, the under-trained and over-stretched state examiners relied heavily on the reports of a supposedly independent auditor. The certified public accountant later turned out to be a Hyfin member who falsified the condition of the credit union.

In 1985, a State Investigation Commission probing into the affairs of New York City Taxi and Limousine Commission Chairman Jay Turoff notified the Banking Commission of problems at the credit union, but the department did not act, it said, so as not to interfere with the investigation.

The Commission's investigation uncovered a story that might have served as a plot for a movie—whether a "Godfather" film or a Woody Allen comedy is best left to the reader to decide.

The main figure in this story was New York's Taxi and Limousine Commissioner Jay Turoff. His relationship with Hyfin began in 1979 when he "met with Edmund Lee, Treasurer of the Hyfin Credit Union," according to the U.S. Circuit Court of Appeals, Second Circuit.

"Turoff controlled the regulation and licensing requirements of the nearly 12,000 medallion taxicabs in New York City; Lee controlled the finances of the third largest state-chartered credit union in New York State. During that meeting, Lee explained that Hyfin generally did not report sizable deposits to the IRS and that if Turoff opened an account at

[196] "State: We Were Had on Hyfin," Newsday, combined editions, April 16, 1986, p. 7.

Hyfin, the interest earned (called "dividends" in the credit union context) would not be reported. . . . Subsequently, Lee opened (an account) in Turoff's name with Turoff's initial deposit of $10,000. At the same time, Turoff obtained a $10,000 loan from Hyfin.

“Over the next five years Turoff made a number of sizable deposits into his account, but he never reported the substantial interest income generated to the IRS. In return for these benefits, Turoff supplied Lee with confidential Taxi Commission lists of medallion taxi owners, which enabled Lee to review and approve loan applications by taxi owners more quickly than competing loan institutions.” [197]

New York Mayor Koch had instructed Commissioner Turoff to find a replacement for the mechanical taximeters then in use that made it possible for taxi drivers to conceal revenue. An Israeli company had an electronic taximeter that fit the purpose, but according to news reports, it wanted an exclusive contract to furnish them to New York cabs. Turoff in 1981 told a friend about the situation and urged him to develop and market a competing electronic taximeter. He said he could guarantee a market by mandating the use of electronic meters in every medallion taxi in New York City. The friend and a married couple the friend knew formed a company, Electronic Compumeter, and developed a prototype meter. Turoff brought the owners of the company to Hyfin, which loaned them $2 million through false accounts to produce the meters. Such a commercial loan was illegal for the credit union to make, as was the credit union's agreement not to report interest on the participants’ deposits to the IRS.

In return, Hyfin would provide loans to medallion owners to purchase the new meters, and Lee, the credit union’s treasurer-manager, was to receive a $100 “commission” for each meter sold, which at the time he expected would reap him about $1 million. So when Turoff demanded $30,000 in return for assurance that the Taxi and Limousine Commission would carry through on mandating installation of electronic-receipt

[197] Cited in July 14, 1988, decision upholding convictions of defendants.

meters, Lee made the payment. The new meters proved defective, however, and the venture failed, leaving Hyfin with a $1.5 million loss.

A U.S. District Court jury found Jay Turoff guilty of conspiracy to defraud the United States in the collection of tax revenues. Turoff was sentenced to concurrent three-year terms on each count for which he was convicted, four months to be served in prison and the balance on probation. He was also fined $50,000.

Two of the Compumeter owners, Alan and Harriet Silver, were found guilty of conspiracy to defraud the United States in the collection of tax revenues and making false statements in their joint federal tax return for the tax year 1984. The Silvers were each sentenced to concurrent three-year probationary terms, with a special condition of four months of house detention and 200 hours community service, and each of them was fined $25,000.

The credit union engaged in other illegal activities that became the basis of criminal and civil suits. Among other things, it gave $12.5 million in fraudulent loans to Bartholomew Rivieccio, a former New York City police detective. He invested it in 17 residential buildings. In return, the credit union's officers received shares in the venture. Rivieccio was convicted in federal court of conspiracy, mail fraud, bank bribery and bank fraud and other charges

''The defendants treated Hyfin Credit Union like their personal piggy bank, to be broken into whenever they needed some easy cash,'' the United States Attorney in Brooklyn, Andrew J. Maloney, said.[198]

Lee pleaded guilty to conspiracy and fraud, admitting that he bribed public officials and defrauded depositors of more than $15 million. He went to prison.

The Hyfin closure cost the National Credit Union Insurance Fund some $50 million, the highest single claim up to that

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[198] "7th Suit to Recover Hyfin Funds Is Filed," The New York Times, October 18, 1987.

point. Stung by the Hyfin failure, NCUA began a review of losses to the insurance fund due to fraud. In a white paper to the NCUA Board, General Counsel Robert Fenner reported, "the credit union system and the National Credit Union Share Insurance Fund have suffered substantial losses in recent months from cases involving what has now become a rather distasteful topic for credit unions: 'insider dealings' and 'conflicts of interest.'"

Pointing out that while the "number of known cases is very small as a percentage of all federally-insured credit unions," Fenner noted that "(the) aggregate (cost to) the NCUSIF has been severe." These expenses depleted funds that "would otherwise be used to build Fund equity or pay dividends to federally-insured credit unions . . . . Thus, the cases have a direct 'bottom line' effect on all federally-insured credit unions." [199]

Several more examples were given in the white paper, indicating that credit unions were not immune from fraud, much of which fell into the category of control fraud, i.e., management and directors were heavily involved and used their positions to loot their credit union. However, during this period, credit unions were still well below banks and thrifts for instances of insider crimes on the FBI bank crime report each year, notes Ralph Swoboda.[200]

NCUA summarized Fenner's report in a letter to credit unions.[201] "In our review of these cases, we determined that virtually every problem we encountered was a violation of a law or regulation already on the books, ranging from provisions of the U.S. Criminal Code to the rules of NCUA and the State Supervisors, to the Common Law doctrine of fiduciary responsibility. We concluded, therefore, that the solution does not lie in promulgating new restrictions, but rather in

[199] Fenner, Robert, NCUA General Counsel, "NCUA Insider Dealing White Paper to NCUA Board," July 3, 1986.

[200] Swoboda, Ralph, communication with author, May 15, 2012.

[201] NCUA Letter No. 84, August 6, 1986.

improving our efforts at education, investigation and enforcement."

The letter outlined steps NCUA was taking to improve supervision of credit unions, including working with the National Association of State Credit Union Supervisors (NASCUS) to develop a joint credit union exam and joining forces with state supervisors to examine problem state-chartered credit unions.

Stating that half of the losses to the insurance fund over the preceding two years had been related to business lending, NCUA proposed banning business loans to credit union insiders, their associates and family members. Other proposals would have limited the amount loaned to individuals for business purposes and restricted the total dollar volume that credit unions could lend for business purposes.

The credit union community was not enthusiastic about NCUA's proposal. Peter Manfredo, marketing director for the New York State Credit Union League in Albany, said its members "obviously don't want to be regulated any more than they already are. We would hope the credit unions would clean up their own act."

Steve Raver, the National Credit Union Administration's Region 1 director in Boston, said public attention now focused on the problem of insider dealings could encourage the credit union industry to develop its own solutions. "I have never seen abuses in any credit union to the degree they were discovered in Hyfin," he said. "Hopefully, we will all learn from the experience."[202]

[202] "Feds propose crackdown on credit union loans," Newsday, Long Island, N.Y., September 3, 1986. pg. 37.

Credit Unions Gone Wild

Here are several cases listed in the NCUA report:

- *A credit union where examinations in 1984 and 1985 indicated insider loans totaling $650,000 to members of the credit committee and board, including $97,000 in unpaid interest on the loans. Many of the loans had been extended or rewritten without payment of late fees or past due interest. A person who provided professional services to the credit union and who was not in its field of membership received loans and a line of credit in excess of $1 million.*
- *A credit union was liquidated and its assets sold to another federal credit union after NCUA found the treasurer had taken over a small company whose ownership had been transferred to the credit union to satisfy a debt. The treasurer operated it for himself and his family while taking money from the credit union to improve the business.*
- *A two-month-old state-chartered, federally insured credit union received more than $3 million deposited by a public unit. The money was loaned to at least 14 credit union officers, directors, and other volunteers and several sham corporations controlled by the insiders.*
- *Two federally insured credit unions were controlled by the same management. The manager "effectively exercised absolute control over the credit unions and nine related corporations." The corporations "were ostensibly established to provide various services to the credit unions and their members . . . . Instead they provided a means of disbursing credit union funds for the manager's benefit."*

NCUA did modify its proposed rule somewhat to meet credit union objections, but the main thrust was unchanged, and the rule became effective in mid-1987. Among other things, it banned business loans to paid senior management,

compensated volunteer directors (i.e., treasurer-managers), and immediate members of their families. It prohibited senior management and loan officers from receiving fees and commissions for underwriting, insuring, servicing, or collecting business loans, and it outlawed preferential loan terms for board and committee members. It limited business loans to any single borrower to 20 percent of the credit union's reserves.

By switching in 1987 from its "Early Warning System" to the "CAMEL" system, NCUA also brought its criteria for measuring credit union health into closer agreement with the standards used by banking regulators and many state credit union regulators. CAMEL rated Capital adequacy, Asset quality, Management, Earnings, and Liquidity management. Each factor was scored on a five-point system, ranging from 1 at the highest to 5 at the lowest. A composite rating was also given. Code 3 and below indicated below average performance, while Code 5 called for NCUA assistance or conservatorship.

Chapter 31

And Then Came Franklin [203]

The people of the Franklin Street black community in Near North Omaha, Nebraska, loved their little community development credit union. It was founded in late 1968 or early 1969 (depending on the source of information) in the wake of three days of rioting in a community shaken by the assassination of Martin Luther King and then angered by the visit of segregationist presidential candidate George Wallace to Omaha. The credit union's founders were concerned that their neighborhood lacked financial services to help them rebuild.

The National Credit Union Administration nearly shut down Franklin Community Federal Credit Union in 1970 as it tightened financial requirements in the wake of the creation of federal credit union deposit insurance. But after black

[203] Much of the information in this section is drawn from the extensive reporting of the Omaha World-Tribune.

businessman Lawrence E. King, Jr., took over as manager, and the Nebraska Credit Union League and other credit unions pitched in financially, as did some churches, NCUA stayed its hand.

In 1974, King organized an affiliated Consumer Services Organization to provide financial counseling, advocacy services, and assistance in financial crises. A branch of Franklin was opened in South Omaha.

Franklin enjoyed support among leaders in the wider Omaha community. Suzy Buffett, wife of noted investor Warren Buffet and a strong supporter of civil rights and community improvement, was an early volunteer at the credit union. In 1985, the credit union remodeled and expanded its headquarters on 33rd Street. The half-million-dollar project was financed by a fund-raising drive led by the chairman of the Omaha World-Herald.

The credit union was a friendly place where people knew your name and gave you a hand when things were rough. Among those assisted was Alicia Heisser of 3324 Seward St., who was helped when her home burned in 1982 and later when it was vandalized. The credit union gave strong support to the poor, the disabled, and single parents, she said later.

Lucinda Sampson, 72, took her bills to the credit union, where they would write checks against her account and mail them for her. "They paid any kind of bill. I didn't have to worry," she said. Franklin employee Neil Seltzer picked up groceries at a food pantry for members who couldn't make it on their own. "If someone needed help in understanding a letter, we would sit down and explain it," he said. By1986, Franklin had more than 5,000 members.

Manager Larry King was a tall, heavy-set, charming man, a striver, with expansive, even grandiose ideas. In addition to overseeing the credit union, he ran a food catering business and a cafe, among other enterprises. He and his wife Alice lived a life of expensive cars and jewelry, a fine home in one of the best neighborhoods of Omaha, and big parties attended by leaders in the community. He earned only $16,200 a year at

the credit union, but he and his wife explained that their money came from his businesses and his wife's family in Jamaica.

Originally a Democrat, King switched parties in 1981, saying he believed blacks were too reliant on the Democratic Party. A good singer, he performed at GOP events, contributed generously to GOP campaigns and conservative causes, and formed an organization called the Council of Minority Americans, whose sole purpose, apparently, was throwing a $100,000 party at the 1988 Republican National Convention in New Orleans. King spent so much time in Washington, D.C, that he rented a $5,000-per-month residence off Embassy Row, where he threw big parties for politicians and other leaders.

King claimed to have helped an Episcopal group in New York City organize a community development credit union in 1979. He sought to launch himself as a consultant on forming community development credit unions. But when he visited Minneapolis in 1986 to do a presentation, he made the wrong impression by flying in on a chartered jet with an entourage that he brought to the meeting in two limousines.

"He (King) said he had friends in high places. He offered drinks and dinner on the house and made a very splashy presentation, with very glitzy brochures. He had a first-class presentation, but I kept wondering what was in it for him," Jeff Schneider, who represented the Mayor's office at the meeting, later said. The wary Minnesota conferees declined to follow up the relationship.

The Minnesotans were not the only people who suspected something amiss. There were troubling signs for those who chose to read them. The credit union reported some $2.5 million in assets, sufficient to support two or three employees, but Franklin had some two dozen employees, their salaries paid by the affiliated Community Service Organization, which listed a total of 66 employees on its payroll. "Grants," explained King. Some employees suspected something was

amiss. But they said nothing. "(It) wasn't my responsibility," said one later.

Depositors seeking to withdraw funds from the credit union were sometimes told that the credit union was temporarily out of cash. Employees gave various excuses—loan demand was heavy, a member had just cashed a large certificate of deposit, the credit union had just mailed out a large number of interest checks, or the cash was tied up in an investment at the moment—come back later and we'll have your money.

The National Credit Union Administration found no evidence of fraud during its annual examinations but did nag the credit union to correct record-keeping shortcomings and to get annual outside audits.

Such an audit in 1985 found no problems. However, the Internal Revenue Service and the FBI were investigating the tax returns of the Kings and the failure of the credit union to submit the 990 form required for nonprofit organizations. In November of 1988, they interviewed an employee who confessed that the credit union was attracting millions of dollars in non-member deposits not recorded in the public books.

The IRS called NCUA to tip it off. A week later, on Friday, November 23, 1988, NCUA representatives, accompanied by IRS and FBI agents, seized control of Franklin Community Federal Credit Union. The agency had been viewing Franklin as a $2.5 million asset credit union not posing much risk to the insurance fund—instead, it discovered a classic Ponzi scheme.

NCUA rules permitted low-income credit unions to accept non-member deposits. While depositors sometimes were having trouble getting their money out, employees of the credit union were "dialing for dollars" with the pro-mise of high interest rates in return. The new funds were used to cover financial shortfalls, and the flow of CDs was recorded in a separate set of computer tapes hidden from auditors and examiners.

Franklin Community had taken in some $42 million in such "off the books" deposits (mostly CDs) from non-members who wanted to contribute to community development. Among them was an order of Catholic nuns, which deposited about $2 million, an amount far in excess of the $100,000 covered by federal share insurance.

Part of the money from CD deposits went to finance the operations of King's Community Service Organization, which was paying out a million dollars a year in salaries to employees, some of whom actually worked in various King businesses. But more than $12 million went to fund the business ventures, lifestyle, and ambitions of King and his wife. It turned out that Larry King's businesses made little or no profit and his wife had no family fortune. In addition, the credit union's chief accountant, E. Thomas Harvey, and his mother reportedly appropriated some $780,000 for their personal use. In all, some $39 million in depositors' money had vanished.

The news rocked the city of Omaha, and the subsequent investigations, civil suits, and criminal trials provided news fodder for years. Prolonging the uproar were allegations that King and the credit union, along with some prominent citizens, were implicated in the sexual abuse of minors. Investigators later dismissed those allegations, but books and Internet sites continue to chew over whether there was a cover-up.[204]

The Kings initially denied any wrongdoing, King claiming that he relied on subordinates at the credit union and spent little time there. He was indicted May 9, 1989, on 40 charges of conspiracy, embezzlement, wire fraud, mail fraud, bank fraud, false tax returns and false entries in credit union books.

A psychiatrist examined him and concluded that he suffered from "probable delusional paranoid disorder, grandiose type." The presiding magistrate declared him unfit for trial and ordered treatment at a federal hospital. After

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[204] Child-abuse attorney and former state senator John W. DeCamp argued that there was a massive cover-up of these activities in his book *The Franklin Cover-Up*, 1996, AWT, Inc., Lincoln, Nebraska.

treatment, King was judged capable of being tried. He pleaded guilty to three of the felony charges (conspiracy, embezzlement, and making false entries) and was sentenced to 15 years in federal prison.

His wife Alice also was indicted on a number of counts, but it would have been more difficult to prove that she was a participant in the crimes. She eventually pleaded guilty to one count of tax fraud and was sentenced to three years in prison.

Five other figures in the case were indicted on various charges, including Franklin's chief accountant, E. Thomas Harvey Jr., and his mother, Mary Jane Harvey. They pleaded guilty to embezzlement and tax evasion and agreed to testify at the Kings' trial. Harvey eventually was sentenced to four years and 3 months in prison for embezzlement and tax evasion and his mother, who was 70 years old, received a three-year and 10-months sentence for the same offenses.

Three employees, Robert Morley, Noel Seltzer, and Larry J. Murray, who had sold CDs by phone, pled guilty to charges that they did not report the income they received in commissions on the sales. Morley was placed on probation for three years, put under house arrest for five months and fined $1,000. Seltzer was given seven months in prison. Murray was sentenced to six months in prison with work release privileges.

As might be expected, the Franklin scandal touched off hearings by House and Senate banking oversight committees. Nothing much resulted from these hearings, but they once again demonstrated how sensitive lawmakers were to bad news from the credit union movement.

But the Franklin case had a very negative impact on the low-income credit union community, which was just recovering from the impact of Reagan administration poverty policy changes noted earlier. The National Federation of Community Development Credit Unions (NFCDCU) had responded to government cutbacks by developing a number of new programs to inject capital into low-income credit unions, including a Capitalization Program that in 1986 grew from some $100,000 to nearly $1 million through grants from the

John D. and Catherine T. McArthur Foundation and the Seton Enablement Fund. The program continued to grow through donations from the Presbyterian Church (USA) Foundation and Chemical Bank. But the impact of this progress was severely blunted when NCUA reacted to the Franklin imbroglio by placing limits on non-member deposits and by reducing the number of credit unions eligible to be denoted "low income" from 325 to 195.

"The decision to limit non-member deposits represented a curious response to the problem, however," observed John Isbister. "The cause of the problem was fraud, not non-member deposits. One would have thought the proper response was to rethink the examination procedures which had allowed the fraud to go undetected until it was too late to save the credit union."[205]

In the face of protests from credit unions, the NCUA did relax the new rule somewhat, Isbister noted, to allow regional directors to make exceptions in some cases. However, low-income credit unions remained limited to non-member deposits equal to 20 percent of their total deposits, or $1.5 million in non-member shares, whichever was greater, and it was difficult to wrangle an exception.

While cases like Franklin tarred the credit union movement, credit union failures seldom resulted from fraud. Credit unions went under for such mundane reasons as faulty lending operations, inept internal procedures, and sponsor failure, NCUA reported. And in fact, such failures were declining steadily even as conditions in the banking and S&L industries worsened.

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[205] Isbister, John, *Thin Cats: The Community Development Credit Union Movement in the United States,* 1994, Center for Cooperatives, University of California, p. 186.

Chapter 32

The S&L Mess Gets Messier

Lawmakers had much more on their minds than credit unions. The savings and loan industry was unraveling at a rapid pace, and it was becoming evident that Congress and the Reagan Administration needed to act. In 1987, Congress adopted the Band-Aid solution of authorizing the thrift insurance fund to borrow up to $10.8 billion, to be repaid eventually by thrift premiums. Though tougher solutions were needed, the complexity of the issues involved, the question of how any bailout would be financed, and the political implications of acknowledging the seriousness of the problem combined to encourage delay.

"The political parties looked at the S&L disaster in the same way they assessed nuclear war: it was to be avoided at all costs because it carried the same risk of 'Mutually Assured Destruction,'" former FDIC Chairman William Seidman recalled.[206] It was mentioned only once in the 1988 presidential campaign, by Democratic nominee Michael Dukakis.

And not only the S&Ls were in trouble. Bank failures had been rising through the 1980s. Larger banks were grappling with problem loans to Latin America. Smaller banks were dealing with regional recessions—farm bankruptcies in the Midwest, and falling oil prices and real estate values in the "Oil Patch" of the Southwest.

Bank failures reached 279 in 1988, representing $54 billion in assets. The $18 billion FDIC fund had its first operating loss in its history, and those losses would continue through 1991. As a result, the National Credit Union Insurance Fund was the healthiest of the three federal deposit insurance funds, with $1.26 in reserve for every hundred dollars of insured deposits, a total of some $1.9 billion.

In a visit to William Seidman, head of the Federal Deposit Insurance Corporation (FDIC), CUNA's Ralph Swoboda and

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[206] Seidman, L. William, *Full Faith and Credit*, Times Books, 1993, p. 190.

Seidman passed the door to the FDIC's credit union. "That's the only solvent institution around here," Seidman joked.

The challenge for the credit union movement was to avoid being sucked into the growing crisis. A warning flag was a proposal by Representative Gerald D. Kleczka (D-Wisconsin) to merge the three federal depository insurance funds to provide money to save ailing savings and loans.

This would have made banks and credit unions liable for part of the costs of resolving the S&L crisis. It would also have invited merger of the regulatory agencies, with credit unions ending up under banking regulators with little knowledge of, or sympathy for, their work. "If funds are merged, regulatory functions will be merged, and it'll be goodbye credit unions," warned CUNA's new chief lobbyist, Chuck Zuver in 1988.[207]

Congress did not act on the proposal that year, but credit union lobbyists were worried about what the next Congress and Administration might do. It was becoming clear that $50 billion or more in tax money would be required to clean up the S&L mess. Besides an insurance funds merger, Congress well might decide to tax credit unions to help pay the tab. "Bankers, especially the smaller ones, are using the S&L crisis to challenge not only the independent regulatory structure of credit unions but also their tax exemption. Our job will be to counteract any 'disinformation' they generate on Capitol Hill," said CUNA lobbyist Richard (Sandy) Beach [208]

Chapter 33

Where Credit Unions Stood

Though they remained niche players, credit unions by the late 1980s were growing rapidly and gaining public attention, both favorable and unfavorable. Gone were the days of the late 1970s when they struggled to find money to lend. Thanks to the new powers granted them in the 1970s and early 1980s,

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[207] "S&L Crisis, Taxation Linked to Other Issues," Credit Union Magazine, November, 1988, p. 47.

[208] "Spreading the News to Lawmakers, CUNA 1988 Annual Report, p. 15.

they were attracting a growing share of consumer savings. In 1980, they had held 4.4 cents of each consumer savings dollar —by 1988, this had grown to 6.2 cents, still a modest amount but a 41 percent increase in market share.

The composition of member savings was also changing. Regular share accounts had declined from three-fourths of total credit union savings in 1980 to just over half by the end of 1988. The bulk of the remainder, including a growing percentage of IRAs, was held in share certificate and money market accounts, with the rest, just over 9 percent, in share draft checking accounts.

Thanks to this inflow of savings, many credit unions were awash in liquidity—savings not on loan to members. On average, of each dollar of member savings, credit unions were able to loan out only about 71 cents.

Idle cash earns nothing, so the challenge was to find ways to invest the leftover funds profitably. The largest share of the credit union surplus, 31 percent, was placed with other financial institutions, especially savings and loans and mutual savings banks, and 30 percent was invested in government and federal agency securities, ranging from treasury notes to GNMA (Ginnie Mae) mortgage securities. Twenty-two percent was placed with corporate credit unions. Another 12 percent was invested in other ways.

NCUA was concerned about longer-term investments, because their value could drop considerably in a period of rising interest rates. In a 1988 report to the NCUA board, Chief Economist Gordon Daniel noted that "On June 30, 1987, Federal credit unions had $9.2 billion invested in intermediate and long-term government securities, representing 8.8 percent of all assets. Between December, 1986, and June, 1987, unrealized losses from these securities totaled about $511 million as a result of the spring 1987 interest rate spike . . . . For some credit unions unrealized investment losses exceeded total capital, including regular reserves. Needless to say,

NCUA examiners have been working with these credit unions."[209]

He gave the example of an investment yielding 8 percent per year. If interest rates rose by 3 percent, a one-year instrument would experience a 2.7 percent drop in value. But the value of a 20-year instrument would decline by 24 percent.

Much more than bad loans, over the next two decades, bad investments would turn out to be the Achilles heel of the credit union movement.

Adding to the high liquidity was that, thanks to the "car wars" and other competition, the credit union share of installment credit had declined from 14 percent in 1980 to under 13 percent in 1988.

The credit union market share would have shrunk even further if not for growth in their mortgage lending. In 1986, anxious to increase their loan portfolios, many credit unions expanded their mortgage lending, and many more decided to enter the mortgage market to take advantage of the red-hot housing market, Niel Moser, senior vice president of CUNA Mortgage Corp., told Newsday.[210]

In 1980, some 12 percent of credit unions had offered first mortgage loans. With the help of credit union mortgage companies like CUNA Mortgage, this had grown to 30 percent by 1988. Among credit unions offering these loans, first mortgages made up nearly a fourth of their total loan portfolios. In addition, credit unions were expanding their second mortgage and home equity loan lending.

"Borrowers who include their credit unions in the search for mortgage money are often pleased with what they find, according to Bill Hampel, chief economist at the Credit Union National Association, a Madison, Wis.-based trade group that represents the country's 16,000 credit unions," reported the

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[209] Daniel, Gordon, "Risks in Long-Term Investing," National Credit Union Administration, Research Study Number 8, p.1.

[210] "Credit Unions Into Mortgages," Newsday, Altoona Mirror, Sunday, November 5, 1989, p. C5.

San Diego Union.

"The pricing practices followed by the country's largest credit union as measured by assets—the Navy Federal Credit Union based in Vienna, Va.—is a case in point. Recently, it was charging 7.625 percent and two discount points for a one-year adjustable rate mortgage. By comparison, the national one-year adjustable rate was averaging 8.2 percent plus 2.34 discount points during the same time period, according to HSH Associates, a mortgage reporting service headquartered in Butler, N.J."[211]

Despite their advances into mortgage lending, however, credit unions represented only about 2 percent of the total mortgage market, but this would grow in future years.

The increasing importance of credit union mortgage lending did not escape scrutiny by the National Credit Union Administration (NCUA), the press, or competitors.

Just as he had warned about the risks of long-term investments, NCUA chief economist Daniel Gordon, sounded an alert in a report to its Board in 1989 about the risks of holding long-term fixed-rate mortgages. (As opposed to mortgages sold to the secondary market through companies like CUNA Mortgage.) He said that credit unions that were not managing their portfolios properly could be "in serious trouble" if interest rates rose, as the S&L industry found its portfolio of fixed-rate mort-gages "underwater" in the late 1970s and early 80s. [212]

Just as with investments, he estimated that if interest rates rose 3 percent, a mortgage yielding 8 percent and maturing in one year would experience a decline in its value of only 2.7 percent. But the value of a 20-year instrument would decline by 24 percent.

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[211] "Not-for-profit' credit unions can offer top mortgage terms," The San Diego Union, San Diego, California, November 6, 1988. p. F.5

[212] Daniel, Gordon, "Mortgage Lending by Credit Unions: Assessing the Risks," Research Study Number 10, National Credit Union Administration, October, 1989.

A credit union that was forced to realize its losses would draw first on undivided earnings and then its reserves, eating into its capital cushion. Credit unions with low levels of capital were the most vulnerable, Gordon warned. He urged credit unions to make more use of adjustable rate mortgages and to sell more of their fixed rate mortgages to the secondary market (which could be done through CUNA Mortgage).

Credit unions also were making inroads into the revolving loan market through credit cards, assisted by credit card processors specializing in their niche, such as CUNA Service Group. By 1988, more than 22 percent of credit unions offered credit cards, a 13 percent increase from the previous year. Because most of those offering credit cards were larger credit unions, more than two-thirds of the nation's credit union members had access to this service. However, many members continued to use bank or thrift credit cards despite their generally higher interest rates.

Bankruptcy among members continued to be a concern to many credit unions. Amendments in 1984 to the 1978 bankruptcy act had failed to stem a rising tide of personal bankruptcies, which nearly tripled between 1979 and 1987. In response, CUNA named another bankruptcy task force to gather data and make recommendations.

The task force reported that rising rates of bankruptcy were mainly due to rising debt loads on consumers and that "changes in the bankruptcy code have had a relatively small effect on credit unions."[213] NCUA noted that only about one-third of the rise in bankruptcies was probably due to the more liberal 1978 law. Instead, the primary causes included bankruptcy lawyer advertising, high interest rates, the liberalization of credit standards, loss of stigma regarding bankruptcy, and economic conditions like inflation and recession.[214] In addition, many loan losses attributed to

[213] Report by CUNA Bankruptcy Task Force at an Open Forum Session, CUNA's National Convention and Exposition, October 2-5, 1988, pp. v and vii.

[214] "Background on Bankruptcies," Research Study No. 7, NCUA Office of the Chief Economist, March, 1988, p. 3.

bankruptcy would probably have occurred without it. All together, most credit unions did not suffer much financially from the rising bankruptcy trend; their balance sheets were affected much more by other factors.

However, bankruptcies represented a sore point for credit union boards and managers. They recognized that most bankruptcies were in response to desperate circumstances such as large medical bills, divorce, or loss of job, but they felt that some individuals abused the process, which hurt more conscientious members in the form of higher interest rates on loans and lower rates on savings. They pointed to abuses such as individuals piling up large debts just before bankruptcy, transferring assets to relatives, and going on spending sprees before filing for bankruptcy. CUNA and the National Association of Federal Credit Unions (NAFCU) joined a coalition of creditor groups, including bankers, Visa, and retailers to seek legislative action to curb such abuses. This put them on the opposite side of the table from their traditional consumer advocate allies, who resisted tightening personal bankruptcy requirements.

Another matter of concern to credit union at this time was Regulation CC, a rule written by the Federal Reserve Board after Congress approved the Competitive Equality Banking Act of 1987.

The act restricted the length of time banks could hold deposited checks before allowing customers to withdraw the funds. The check holds gave banks time to make sure the checks were valid. The allowable check hold time under Regular CC was shorter for local checks. The regulation treated share drafts as non-local because of the use of payable through banks. The Credit Union National Association (CUNA) and Dearborn Federal Credit Union challenged this provision in federal court and won, thus ensuring local share drafts would be treated as local.[215]

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[215] Credit Union National Association, Inc. Et Al, Plaintiffs, v. Board of Governors of the Federal Reserve System, Defendant, July 27, 1988.

Chapter 34

Movement Continues to Consolidate

As the 1980s moved toward their end, the credit union movement was growing stronger. Loan losses had declined steadily. The capital-to-asset ratio of federally insured credit unions was rising from 6.2 percent in 1986 to 6.9 percent in 1988, while late loan payments and loan charge-offs were falling.

The credit union movement also was evolving rapidly. The changes in membership policies by NCUA in 1982 had set off a wave of mergers and additions of select employee groups (SEGs). This paralleled consolidation in the commercial banking and thrift industries.

"Before 1982, credit union mergers were induced by regulatory authorities or the board of directors for one or more of the following reasons: poor asset quality; inadequate reserves or profitability; or the retirement of a chief executive officer without a successor. In this situation, the credit union could no longer function without the assistance of another financially stronger, perhaps larger, credit union," notes CUNA economist Steve Rick. [216] After that date, most mergers were voluntary as management sought to compete more effectively in the new marketplace where credit unions, banks, savings and loans, and other providers fought head to head for the patronage of increasingly sophisticated consumers.

There were many advantages to growth.

While the smallest credit unions often had a close relationship with their members, they found it difficult to offer them much more than "plain vanilla" services like passbook savings, direct deposit, and auto loans. For other services, their members relied on banks and thrifts. While some members were satisfied with plain vanilla, increasing numbers of small credit unions sought mergers with larger ones so they could offer their members a broader array of services, ranging

[216] Rick, Steve, "Credit Union Restructuring: A Response to the Developments in the International Finance Industry," 1998, World Council Monograph No. 11.

from share drafts to credit cards to mortgages to financial counseling. A merger also could offer greater convenience for members, by giving them access to more branches and ATMs.

In addition, an increasingly complex regulatory environment made it difficult for small credit unions to keep up with legal requirements. Larger credit unions could afford staff to keep track of and ensure compliance.

New technologies like computers required considerable investments that small credit unions found difficult to make. Larger credit unions could more easily afford these technical advances. At the same time, these technologies made it much easier to serve large numbers of members in diverse locations.

Growth afforded economies of scale that made for greater employee productivity, resulting in better rates and service for members. Interestingly, with many banks and thrifts, growth above the $100 million asset mark does not seem to result in further economies of scale—indeed, it may result in higher costs. But with credit unions, such economies from growth are found at all asset levels.[217]

The fields of membership of many credit unions were rapidly changing as the 1980s progressed. The new interpretation of the common bond requirement by NCUA led many credit unions to begin adding small or "select" employee groups, SEGs, as they were called, to their fields of membership. Besides the advantages of greater size, a membership base spread across a number of groups helped to insulate a credit union against economic downturns in any one industry or sector of the economy. Large credit unions, over $50 million in assets, averaged more than 100 SEGs.[218] Alternatively, some were switching to community charters in search of membership growth.

The traditional credit union was often tucked away in some corner of the sponsor company or organization premises, or

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[217] Rick, Steve, "Credit Union Restructuring: A Response to Developments in the International Finance Industry," World Council of Credit Unions Monograph No. 11, 1998.

[218] According to CUNA's 2007 Credit Union Services Profile, p. B23.

even in the home of its treasurer-manager. This was hardly practical for a credit union adding SEGs or expanding to a community charter. More and more credit unions were moving out of sponsor premises and constructing new buildings, perhaps with a branch still located within the sponsor's workplace. A larger credit union might have branches in several parts of its service area. By 1988, a fifth of credit unions had at least one branch. Because many of these were larger credit unions, they served some 64 percent of members. [219]

Mortgage lending and credit cards symbolized the increasing diversity and sophistication of credit union services. A snapshot of the movement as seen in Florida in 1988 was given in an article in the Orlando Sentinel.

It noted that many credit unions remained plain vanilla. "The average credit union in Central Florida has one or two full-time employees, who are typically paid less than $25,000 a year, according to statistics compiled by the National Credit Union Administration. Many of those institutions cannot afford the computerized data processing that has become standard at banks and thrifts. They still laboriously record all transactions manually on ledger cards or directly in bound ledgers."[220]

However, the new face of credit union service was demonstrated by Eastern Airlines Credit Union, the newspaper reported. Originally chartered to serve airline employees, it began to diversify in 1983 after the airline began having financial problems. It began merging with other credit unions and added some 650 select employee groups, including Avis and Budget Rent-A-Car to become the fifth largest credit union in the nation. Of its 135,000 members, only 30,000 were airline employees.

The Sentinel observed that "Eastern Airlines Credit Union's branch office in Orlando looks like a bank. It has custom-made lavender teller counters, wood accents and wall-to-wall gray

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[219] Ibid.

[220] "More Like Banks Credit Unions Offer a Variety of Services to their Members," Orlando Sentinel, December 13, 1988, p. 23.

carpeting. And, increasingly, Eastern and other credit unions are beginning to act like banks, offering checking accounts, home loans and individual retirement accounts. Eastern even has its own trust subsidiary."

Not noted by the newspaper's report was the fact that the credit union's diversification helped cushion it against economic shocks—as was demonstrated the following year when Eastern Airlines filed for bankruptcy.[221] The credit union symbolized its independence from the airline by changing its name to Eastern Financial Federal Credit Union. (It continued in operation under that name until 2009 when losses due to the Great Recession forced it into conservatorship and merger with Space Coast Credit Union, Melbourne, Florida.)

Despite continuing shrinkage in the number of credit unions, down from 21,467 in 1980 to 15,719 by the end of 1988, membership had grown to 58.6 million, nearly a quarter of the country's population.

Chartering of new credit unions was almost at a halt. But in 1987, NCUA approved perhaps its most controversial charter ever—for AARP Federal Credit Union. The credit union was open to members of one of the nation's biggest and most influential organizations, the American Association of Retired Persons.

Headed by P.A. Mack, Jr., who left the NCUA board to take the post, the new credit union did not offer face-to-face services. Instead, AARP FCU members could access its services via a toll-free number and make deposits or withdrawals at any of the 19,650 automated teller machines in the nationwide PLUS network. The new credit union offered a money market account with limited checking and a Visa credit card with a low annual fee of $10, an interest rate on the unpaid balance of 14.9 percent, and a 25-day grace period.

If only 4 percent of AARP's 28 million members joined the new credit union, its membership would surpass the 850,000 of Navy Federal Credit Union, the nation's largest.

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[221] "Special Report," Orlando Sentinel, December 4, 1989, p. 1.

AARP Federal Credit Union's business plan called for a membership of 2 million within five years, according to one report. An American Banker writer warned, "In terms of brand power, I predict the AARP Federal Credit Union will become one of the best-known nationwide names in the financial services industry within the next five years."[222]

His forecast was wildly off the mark. The new credit union did not take hold. It attracted nowhere near its projected membership, and it found that the seniors who joined were more interested in saving than in borrowing, so its loan to savings ratio was inadequate to maintain healthy earnings. It would close down in June 1990. At the time, however, the charter aroused competitive concerns even within the credit union movement.

Bankers used the example of AARP Federal Credit Union as they stepped up their lobbying against the movement. They argued credit unions were pushing beyond the limits of the traditional common bond, were becoming banks in all but name, had an unfair competitive advantage through their tax exemption, were under-regulated, and were the next big crisis waiting to happen.

One unnamed Massachusetts banker professed to be delighted about the AARP charter, because the new credit union would prove to be such a fierce competitor that it would wake up the banking industry to the credit union threat. "It had to get worse before it could get better," he said, "and this is definitely worse."[223]

Another banker complaint was that the credit union contributions to the federal insurance fund were "double counted," because credit union deposits into NCUSIF were counted by the fund as an asset, while credit unions also could count their contributions as an asset on their balance sheets.

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[222] "The Formidable Threat of AARP'S Credit Union," Michael P. Sullivan, American Banker, September 15, 1988, p. 4.

[223] Massachusetts Banker, June, 1988, quoted in "Good News From the Competition?," American Banker, August 31, 1988, p. 4.

NCUA and credit unions argued that this only indicated that in some respects, a credit union owned their insurance fund contributions, since they would be returned to the credit union's members if it voluntarily went out of business or switched to private insurance. The banks argued that counting the contribution as a credit union asset inflated the net worth of the credit union and made it appear financially stronger than it actually was. (After AARP FCU closed down, the National Credit Union Share Insurance Fund (NCUSIF) returned the credit union's one percent deposit for distribution to members, illustrating why credit unions count their one percent contribution to the fund as an asset in their bookkeeping.)

Bankers were quick to take their case to Congress, where the AARP charter raised some eyebrows. One result was that NCUA tightened its requirements a bit for associational charters, making another AARP-type national credit union unlikely.

CUNA and the leagues responded strongly to these bank charges, arguing that credit unions were granted their tax exemption not on the basis of the common bond but because they were not-for-profit cooperatives dedicated to member service.

Credit unions simply were growing with the times and diversifying to meet changing member needs, they said. Their federal insurance fund was the strongest of the three, and credit unions were in good financial shape.

The battle of words continued as a new administration took power in Washington.

Chapter 35

Credit Unions and the S&L Bailout

The 1988 elections elevated GOP Vice President George Herbert Walker Bush to the White House. They also presaged the long-delayed resolution of the savings and loan crisis.

Bush, a lanky Texas transplant from a wealthy New England family, had been a World War II fighter pilot and later served in a variety of high government positions. He inherited from Reagan a large government deficit and the savings and loan debacle. Unfortunately, during the campaign, he had painted himself into a corner with a pledge of "No new taxes." To cope with the financial problems of the country, he had to break that promise, inflicting a wound on his presidency that would help cost him the next election.

After taking office on January 20, 1989, Bush, as an old Texas expression puts it, decided "to raise the cow's tail and look the situation in the face." He proposed a $50 billion bailout program, funded largely by the taxpayers and partly by premiums paid by S&Ls.

While credit unions initially hailed the proposal, they discovered that the plan dealt with the credit union insurance "double counting" issue by requiring them over an eight-year period to write off their one percent contributions held by the National Credit Union Share Insurance Fund (NCUSIF) as an expense. They would no longer have any claim on it if they voluntarily liquidated or switched to private insurance. Neither could they count it as an asset on their balance sheets. In place of the one- percent contribution system, the fund would begin charging credit unions annual premiums that would count as an expense in the credit union's books.

To outsiders, this might have seemed an arcane issue, but many credit unions considered the proposal a violation of the pact they had made with the government to fund NCUSIF. It was vigorously opposed by the trade associations and by NCUA.

CUNA Chairman Al Williams testified before the Senate Banking Committee and the House Banking subcommittee on financial institutions that the proposal would hike insurance costs for credit unions by 250 percent but it "ironically would contribute not one dollar to help in the S&L crisis." He pointed out that the one percent deposit, although it was listed as an

asset on the books of the credit union, was not counted as capital. Nor was it available for lending to members.

NCUA Chairman Roger Jepsen, appearing before the same House subcommittee in September, 1989, testified to the strength of the credit union movement and its federal regulatory agency. He emphasized the importance of the one percent insurance deposit.

"Credit unions carry this one percent deposit as an asset," Jepsen said. "Thus, they have an investment, an ownership interest, in the fund. They don't simply pay a premium, expense it, and forget about it. They have a clear and immediate stake in the soundness of their fellow credit unions. This industry-wide accountability is a key factor in the continued stability of the credit union system."

Jepsen went on to outline the strong condition of the insurance fund and of the movement as a whole. "Unlike the other funds, the NCUSIF has *never* (his emphasis) had a net loss. Over the last five years, the Fund's average insurance loss per $1,000 of insured shares has been $.34. For comparative purposes, FDIC's average five-year loss per $1,000 has been $1.29. Our loss last year per $1000 of insured shares was $.38 – FDIC's loss per $1000 was $2.72."

The NCUA chairman noted the success of the movement in responding to the challenges of the time. "Despite what the opponents of credit unions have been saying, credit unions have stayed true to their basic mission: serving their members according to their needs. That is the bottom-line reason why in 1988, in the midst of record breaking numbers of failing financial institutions, credit unions had the lowest number of failures in their history."[224]

But by this time, the issue of double counting had become moot, as the one percent write-off was dropped from the Bush program, The issue, however, would continue to be a threat.

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[224] Statement before the subcommittee on financial institutions supervision, regulation and insurance of the House Committee on Banking, Finance and Urban Affairs, September 21, 1989.

In August, 1989, Congress approved the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), and President Bush signed it into law. The act authorized the borrowing of $50 billion in taxpayer funds to resolve failed savings and loans institutions. The ultimate cost with interest would turn out to be $150 billion or, by some estimates, much more.

The Federal Home Loan Bank Board was dissolved and regulation of S&Ls was given over to a newly created Office of Thrift Supervision (OTS) in the Treasury Department.

The Federal Deposit Insurance Corporation (FDIC) was given responsibility for insuring both banks and savings and loans. The S&L fund was renamed the Savings Association Insurance Fund (SAIF). The bank fund was named the Bank Insurance Fund (BIF). The law created a body run by the FDIC called the Resolution Trust Corporation (RTC) to dispose of fatally stricken thrifts.

While the one percent issue had been put to rest for the moment, Congress foresaw the need for more regulatory and insurance reform. It mandated a Treasury study of the federal deposit insurance system and a General Accounting Office (GAO) study of the credit union movement, both to be completed in early 1991. [225]

Chapter 36

Call to Arms

CUNA's chief lobbyist, Chuck Zuver, warned that when the Treasury and GAO reports were presented to Congress, the lawmakers would "address what further changes must be made to the financial system to restructure it so that a similar crisis never occurs again. It is during the hearings to address that question that credit unions will be most vulnerable . . . .

"(Circumstances) and predispositions of decision makers combined with heavy lobbying by credit union enemies practically guarantee the loss of an independent regulator

[225] Now the Government Accountability Office.

unless a monumental credit union effort is undertaken immediately," Zuver wrote Swoboda.[226]

He recommended a "call to arms" to the credit union movement and a "War Plan" to "mobilize credit union unity and grassroots strength . . .with a goal of reaching maximum strength by the (CUNA) Governmental Affairs Conference of 1991."

Bankers were well aware that credit unions could be vulnerable. They stepped up their attacks both on the national and state level.

The big national banks like Citibank were little concerned about credit unions. The issue festered most among regional and community banks, especially the community banks. With the evolution of larger, full-service credit unions, they often found themselves in direct competition with a credit union down the street.

There is no single definition of "community bank," but in the late 1980s and early 1990s, they were generally considered to be banks with less than a few hundred million dollars in assets. The Independent Bankers Association of America (IBAA) and the American Bankers Association (ABA) were in competition for community bank members, and both made fighting the credit union movement a top priority.

"Facing growing competition in the financial services industry, the (ABA) has targeted the credit unions' tax exemption . . . as one of its top legislative priorities. Lobbyists from both sides say they expect the fight to be long and dirty," reported the San Diego Tribune.[227]

It quoted ABA spokesperson Mary-Liz Meany as saying: "It's come to a head in the last few years and part of that is because banks in general are facing an incredible amount of competitive pressure. (Credit unions) are blatantly breaking

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[226] Memo to Ralph Swoboda from Chuck Zuver, July 6, 1989, CUNA Information Resource Center Archive.

[227] "Credit unions' war with banks getting hotter;" San Diego Tribune, San Diego, California, November 6, 1989, p. AA1.

their common bond rules, aggressively marketing and gaining market share in small communities."

In San Diego County, the newspaper reported, the 45 locally based credit unions had a membership of 682,000 and more than $2.5 billion in assets.

Filene Institute

A new resource in the movement's arsenal that would play a growing role in the years ahead—not only in lobbying battles but in helping credit unions adapt to changing conditions—was the Filene Research Institute, founded in 1989 and headquartered in Madison, Wisconsin.

Over the years, little research had been done on credit unions outside of NCUA and other government departments, and the research departments of the major trade organization, especially CUNA. The Filene Research Institute—named after the Boston philanthropist Edward A. Filene, who had subsidized the growth of the early movement—was designed to encourage distinguished scholars to turn their attention to credit union issues. It was conceived by Richard (Doc) Heins, CEO of CUNA Mutual, who drew on his experience and connections as a professor in the University of Wisconsin's business school. The Filene Institute was financed by CUNA Mutual, CUNA, the leagues, and contributing credit unions.

The Institute has commissioned academic research into many issues of interest to credit unions, ranging from taxation to field of membership to board efficiency. Its first executive director was Dave Chatfield, former NCUA board member and later president of the California League. The Institute's research has proven very helpful in dealing with bank attacks and analyzing a wide range of other issues, from governance to technology.

"Few would argue that stiff competition does not exist among local institutions: Twelve banks in the county have

more than $100 million in assets, while 10 credit unions top the $100 million-asset mark," the Tribune said.

It pointed to Mission Federal, with $320.5 million in assets, as the type of credit union many bankers complained about. Between 1973 and 1989, Mission Federal expanded from four to 21 branches, and its field of membership widened to include students, alumni, and employees of nearly every school district in the county.

Its service offerings included automated teller machines, home loans, a travel/tour business, and an auto-finding program.

"We feel (the threat from the bank campaign) is very serious because the people who are going after us are so huge," CUNA President Swoboda told the Tribune. "The banking industry has tremendous resources and they've come after us. I think we have reason to be scared—not because they have merit to what they are doing, but because they have a lot of money."

However, Hal Stephens, president of Mission Federal, noted the hidden strength of the movement. "(We're) people, they are dollars," he told the Tribune. "What we have is the vote. I don't know anybody willing to go to the polling place and vote for their bank."

Indeed, the movement was mustering its strength —people —for the test ahead. In November, 1989, at CUNA's annual meeting in Seattle, the association and its leagues formally launched a major campaign—Operation Grassroots—to mobilize credit union volunteers, staffers, and members to defend the credit union movement.[228] Operation Grassroots would draw on all the resources of the movement. Association economists, for example, would pull together facts and statistics to bolster the credit union case.

[228] At the same meeting, delegates elected CUNA's first woman chairman, Janet Miller, who managed a large federal credit union serving the Air Force Academy in Colorado Springs, Colorado. Miller preferred the title of "chairman" to "chair" or "chairwoman."

The 1990s
Banks vs Credit Unions

Chapter 37

The Year of Preparation

"We want to build the biggest army and have it on call. We are really gearing up for this one," Richard (Sandy) Beach, CUNA's vice president of governmental affairs, told the financial trade newspaper American Banker in January of 1990. "There is no such thing as compromise (with banks). We will go all the way."

The 1990 Governmental Affairs Conference saw a record attendance of nearly 2,000 credit unionists who listened to speakers rallying them to the cause. "It's no longer business as usual," Chairman Janet Miller told the crowd. "Make no mistake, bankers have declared war on us. We can no longer avoid it."[229]

CUNA and the leagues had organized effective grassroots campaigns before, but those earlier efforts were dwarfed by Operation Grassroots. Such an effort required additional funds at all levels of the movement.

The CUNA\CUNA Service Group boards approved funding of $100,000 for the national effort, and CUNA Mutual Group chipped in another $100,000.

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[229] "Operation Grassroots Picks Up Speed," Credit Union Magazine, March, 1990.

CUNA called on leagues and credit unions to budget for sending delegates to Washington, D.C., for a massive demonstration, if necessary. Not in 1990, but in February, 1991, when CUNA would hold its annual governmental affairs conference and the two studies mandated by Congress would be completed.

The association and leagues also launched a massive drive to collect millions of signatures on petitions calling on Congress to leave credit unions alone, to be delivered at the same time as the rally.

Meanwhile, CUNA and the leagues reached out to a number of audiences in a public relations campaign: credit unionists, members, the media, the general public, and Congress.

Among its weapons were “good news stories” collected by the leagues and CUNA about how credit unions benefited their members.

For instance, one California man wrote Senator Alan Cranston (D-Calif.) that in his 73 years he had never found an institution that "has constantly treated me as a human being with intelligence, feelings, and, sometimes, problems" as his credit union, Navy Federal, had—not even the bank at which his father worked for 52 years.[230]

With a certain zest, CUNA distributed bumper stickers to the leagues that said, "Damn the banks, full speed ahead" and "Banks happen."

The bankers were trying to reach out, too, of course, but on the opposite tack. The North Dakota Bankers Association distributed its own bumper stickers: “YOU pay income taxes, Why don’t credit unions?”

The Independent Bankers Association of America asked its members to collect and send in advertisements that showed how credit unions were straining or ignoring the common bond.

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[230] “The Lobbyists” Column, American Banker, December 28, 1989, p. 4.

"Your sharp eyes—and sharp scissors—give IBAA fresh fodder every time you see—and clip—a credit union ad that's questionable," its newsletter said.

The newsletter called credit unions Teflon institutions that had so far defeated attempts to rein them in. The association hoped that the collected ads would "turn that Teflon into Krazy Glue."[231]

As 1990 progressed, the political threats to credit union independence grew even more serious.

A mild recession was putting added strains on the banking system. While the spotlight was on the savings and loans, commercial bank failures were continuing, and the reserves of the FDIC's Bank Insurance Fund were dropping, reaching just 21 cents per $100 by the end of the year.

The credit union movement, in contrast, was in good shape. "The state of the credit union industry in America has never been as bright," researchers Surenda K. Kaushik and Raymond H. Lopez would report in a study of the movement through 1992. "In terms of asset and membership growth, credit unions continue to be among the financial institutions of choice . . ."[232]

However, the economic slowdown, the rising costs of the S&L bailout, and the overall erosion of the banking system were putting tremendous pressure on lawmakers to come up with some solution that well might entangle credit unions.

On August 2, 1990, in the midst of this domestic turmoil, Iraq occupied its small oil-rich neighbor Kuwait at the head of the Persian Gulf. Three days later, President Bush declared that the invasion would not stand. In response to pleas from Saudi Arabia for help in its defense, the U.S. began sending first warplanes and then troops to be stationed in that desert kingdom.

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[231] Ibid.

[232] Kaushik, Surenda K. and Raymond H. Lopez, "The Structure and Growth of the Credit Union Industry in the United States: Meeting Challenges in the Market, American Journal of Economics and Sociology, April, 1994.

Amid these gathering war clouds, mid-term congressional elections were held in November of 1990. Faced with the pressure to do something drastic about the banking system, a number of members of the House Banking Committee were jumping ship and could be replaced by inexperienced freshman lawmakers, who would not be familiar with credit union concerns, CUNA's chief lobbyist Chuck Zuver reported[233].

Adding to the uncertainty, the feisty liberal Henry Gonzalez (D-Texas) was now chairman of the House Banking Committee following the defeat of Fernand St Germain in the 1988 elections. Gonzalez was considering legislation to bring banks, S&Ls, and credit unions under one regulator and to consolidate the three insurance funds. The proposal was anathema to credit unions.

Chapter 38

Rhode Island Crisis

On a sunny but cold and windy New Year's Day in 1991, Rhode Island's new governor, Bruce Sundlun, was sworn into office. Within hours the ex-bomber pilot and multi-millionaire businessman declared a "banking emergency."

The order shut down 45 financial institutions: 10 state-chartered banks and 35 state-chartered credit unions. All had been privately insured through the Rhode Island Share and Deposit Indemnity Corporation, RISDIC.

Federally insured banks and credit unions were not affected. But some of the largest credit unions, like Marquette Credit Union and Rhode Island Central Credit Union, fell under the closure order.

All told, about a third of Rhode Island's one million residents were blocked from accessing some $1.7 billion in deposits. This was about 10 percent of all deposits in Rhode Island's banks, savings and loans, and credit unions.

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[233] Memo from Chuck Zuver to League Presidents, League Operation Grassroots Coordinators, December 31, 1990, CUNA Information Resource Center Archive, Box 868827, Folder 1, Operation Grassroots.

The average deposit was under $6,000, but many depositors relied on their accounts to pay bills and meet emergencies. Small businesses were cut off from funds they needed to pay employees and suppliers. As the news spread on New Year's Day, angry lines formed at some ATMs as depositors tried to withdraw money, only to read messages in English, Spanish, and Portuguese that they could not get their money out.

"It's not a very happy New Year," said one frustrated depositor whose funds were frozen. "I told my wife today, if things keep on like this, I'm going to buy a fireproof safe, put it in the basement, and that's where my money is going."[234] To head off trouble, state troopers were posted the day after New Year's at the doors of each closed bank and credit union.

The crisis had been brewing for months under the administration of the previous governor, Edward DiPrete. With the conquering of inflation, the emphasis on deregulation, and the stimulation provided by the federal deficits of the Reagan Era, the overall economy had seen sustained growth in the later 1980s despite regional problems. But a mild recession arrived in mid-1990. It was not mild, however, in the Northeast, where federal cutbacks in defense spending ended a high-tech boom.

The Northeast's real estate market crashed, with the median value of an existing single-family home falling from $133,000 in the fourth quarter of 1988 to $120,000 in the fourth quarter of 1990. Business and personal bankruptcies soared.

Credit unions in New England saw rising loan delinquencies and falling earnings. Hardest hit were a few large, state-chartered credit unions in Rhode Island that were heavily invested in business and commercial real estate and insured by the Rhode Island Share and Deposit Indemnity Corporation.

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[234] "Rhode Island Closes 45 Banks, Credit Unions," Associated Press, Seattle Times, January 2, 1991.

RISDIC was one of two remaining private insurance funds in the country that covered both banks and credit unions. (As noted earlier, the banks were specialized institutions known as industrial banks.) The fund had no state backing, and as events proved, it lacked the resources to meet its commitments either to member banks or credit unions.

The crisis began in the state's banking community. In May of 1990, RISDIC took over Jefferson Loan and Investment Bank of Cranston, paying out $4 million to depositors. In October, the fund quietly took control of Heritage Loan and Investment Company of Provincetown, where state auditors soon discovered that some $1.3 million was missing. The bank's president, Joseph Mollicone, Jr., was suspected of embezzling the money. The banker went missing himself a week later. (After hiding out for two years under an assumed name in Utah, he reappeared and was convicted of embezzlement and sent to prison.)

RISDIC announced it had taken control of the bank. This set off a classic bank run, with depositors withdrawing $104 million, nearly half of the bank's deposits. The bank was shut down, temporarily at first, then permanently, and the remaining funds distributed to depositors.

The crisis depleted RISDIC's fund and the private insurer asked its members to contribute $8.3 million to restore it to health. But instead, the members began switching to federal insurance.

On New Year's Eve of 1990, RISDIC's board decided to go out of business and turn its few remaining assets over to the state. That triggered the new governor's actions on New Year's Day, 1991.

CUNA was aware of the developing situation, recalled Ralph Swoboda, who was its president at the time, but it did not seem practical for the movement to try to rescue the Rhode Island credit unions. Very early on he got a call from NCUA Chairman Roger Jepsen, who said his advice, his strong advice, was that CUNA not attempt some kind of movement bailout, that it really was a mess and that at the end of the day

it was going to have to be up to the NCUA and the state of Rhode Island to resolve it.[235]

All but two of the RISDC institutions had already applied for federal insurance. But the FDIC and NCUA had to examine these institutions to see if they qualified before bringing them under the federal umbrella. NCUA found that some large credit unions were carrying $400 million in potential losses on commercial and real estate loans. Some had a negative net worth and undoubtedly would not qualify for federal insurance.

To speed the switchover, NCUA and CUNA had proposed that the state of Rhode Island promise to reimburse the federal share insurance fund for any losses at RISDIC credit unions. That would have allowed NCUA to immediately provide federal insurance to all the credit unions. But due to a $200 million state budget deficit and political infighting between outgoing GOP Governor DiPrete and his Democratic successor, the state didn't provide any guarantee.

Chapter 39

Burned in Effigy

To cushion the shock, Sundlun's staff set up regulations to allow depositors at the closed institutions who were in "dire economic need" to withdraw up to $1,000 for food, to pay medical insurance premiums, or to keep their utilities on. The Social Security Administration switched its direct deposit payments from closed institutions to a federally insured bank to permit citizens access.

The credit union movement did what it could to alleviate the difficulties for members of the closed credit unions. Many of the federal credit unions in the state honored checks drawn on twenty-two mainly small credit unions that were expected to receive federal insurance shortly. They also offered emergency loans to members of those credit unions.

The Iowa League contributed $25,000 to the Rhode Island league to provide such loans. When the 22 credit unions did

[235] Interview, August 11, 2004, CUNA Information Resource Center Archive.

qualify for federal insurance and reopened, U.S. Central Credit Union offered $20 million to meet any run on accounts. The money was not needed.

The reopening of the now federally insured banks and credit unions made available some 20 percent of the frozen deposits. But ten credit unions remained closed, including several of the largest. These credit unions either were insolvent or had such severe problems they could not qualify for federal insurance.

To deal with them and the remaining closed banks, Governor Sundlun persuaded the state legislature to create the Depositors Economic Protection Corporation (DEPCO). Legal challenges delayed the operation of the new agency, but six months later, it began its work. The Department of Banking Regulation placed most of the closed institutions into receivership, and DEPCO issued $150 million in state bonds which would be repaid with assets from liquidated institutions and the revenue from a 0.5 percent boost in the state's sales tax. Depositors would be reimbursed fully for lost deposits of up to $100,000 and partially for losses above that limit.

Depositors waiting for their money did not make happy campers. Protesters hounded Sundlun. Some burned him in effigy. Some compared him to Hitler.[236]

The payments to depositors dribbled out over the next several years, with 4.6 percent of the deposits still unpaid as of January, 1993. The state's taxpayers would continue to pay off the revenue bonds and the interest on them for years to come.

Sundlun considered the resolution of the RISDIC crisis one of the major accomplishments of his administration. But not everyone agreed with his assessment. Ultimately, it cost the state of Rhode Island a "bunch of money," Swoboda recalled with some heat, "and if they had any brains, they would have realized that from the beginning. They could have put up the money on Day One, or pledged that it would be there or they

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[236] "Bruce at 86: A Different Kind of Man," Providence Journal special article, 2006, published on the web.

would get it from the Legislature or something. And they could have ended the crisis immediately."[237] It would have been unwound in a reasonable fashion, in Swoboda's view.

Governor Sundlun asked the president of Brown University, Vartan Gregorian, to head a commission to look into the origins of the crisis. What Gregorian and his panel discovered was a credit union, regulatory, and legislative old-boy network that encouraged risky investments and lax regulation out of a complacent attitude that nothing was likely to go wrong.

A relatively few large, state-chartered credit unions, nicknamed "the club" by other credit unions in the state, dominated the league, its service corporation, the corporate credit union, and the private insurance fund.

"The club" had flourished during good times. A liberal state credit union law permitted them to venture further and further into commercial lending, some doubling their assets between 1985 and 1990. An inattentive state legislature and an understaffed Department of Bank Regulation, combined with lax oversight by RISDIC, did little to curb their risky lending..

"Collectively and individually," Gregorian's report stated, "RISDIC staff and directors lacked insurance experience, had little banking experience outside of the small world of Rhode Island state-chartered financial institutions, and possessed modest educational and professional credentials. Nevertheless, they were well compensated and had great confidence in each other's talents and integrity. RISDIC directors seemed generally oblivious to the complex risks for which they were responsible. Examination findings and problems noted at member institutions were filtered out or excused as they were communicated upward with RISDIC. The result was an uninformed board."[238]

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[237] Swoboda, Ralph, Interview, August 11, 2004, CUNA Information Resource Center Archive.

[238] Gregorian, Vartan, "Carved in Sand: A Report on the Collapse of the Rhode Share and Deposit Insurance Corporation," prepared for the governor of Rhode Island, March 14, 1991. The title was a take-off on RISDIC's motto,

In addition, RISDIC had such a narrow base of insured credit unions that when push came to shove, it was not able to absorb major losses

The league's president, Robert Bianchini, was a casualty of RISDIC's collapse. He was widely blamed for his legislative role in leading the opposition to requiring federal insurance in 1985, although it was obvious from Gregorian's report that there was plenty of blame to spread about. He resigned his deputy majority leader position in the state's House of Representatives and did not run for reelection. "I was mistaken" (in opposing federal insurance for state charters)," he said in his letter of resignation. "My mistake was an error of judgment, not an act of self-interest."

Bianchini eventually also resigned his league position, but later he became president of the Oklahoma League, from which he retired in 2005. Deprived of much of its revenue by the closure of several big credit unions, the Rhode Island league turned over its administrative duties to the Massachusetts CUNA Credit Union Association.

The RISDIC collapse nearly spelled the end to private share insurance. Missouri, Texas, Florida, Georgia, and Massachusetts changed their laws to require federal insurance of state charters. NCUA was flooded with almost 800 applications for federal insurance from 14 states in 1991.[239] Kansas followed in 1992.

Today, private share insurance still exists, but only American Share Insurance (ASI) of Dublin, Ohio, (formerly the National Deposit Guaranty Corporation) provides primary credit union deposit insurance in nine states. In these and other states, ASI and the Massachusetts Credit Union Share Insurance Corporation provide protection to depositors on amounts above and beyond federal insurance limits.

"Carved in Stone."

[239] 1991 NCUA Annual Report, p. 4.

Chapter 40

The Big Grassroots Demonstration

The timing of the Rhode Island crisis could not have been worse, from the credit union point of view. The share insurance debacle broke as CUNA and the credit union movement were gearing up for the February, 1991, Operation Grassroots showdown in Washington, D.C. to ensure credit unions were not wrapped into any legislation to rescue S&Ls.

Apart from the S&L troubles, the commercial banking industry was also looking tottery, especially in economically depressed New England, where Boston's Bank of New England was on the verge of collapse and would soon require an FDIC bailout. Big New York banks were also suffering from defaulted real estate loans. More than 1,000 of the nation's 12,400 commercial banks were on the government's watch list of troubled lenders, four times as many as during the 1981-82 recession. The FDIC expected 180 banks with total assets of $70 billion to fail during the year. It was estimated that closing them would reduce the FDIC's fund to $4 billion on hand. Time magazine saw the failure of RISDIC as a red flag for banking in general. "Not since the Great Depression has the outlook for so many banks seemed so grim," it said.[240]

On January 3, House Banking Committee Chairman Gonzalez submitted his legislation to deal with the banking crisis. Apart from consolidating regulation and the insurance funds, the bill proposed a write-down of the one percent credit union deposit in NCUSIF over a period of eight years. This would mean credit unions could no longer claim it as an asset on their books.

President Bush sent his budget to Congress. It called for taxing credit unions above $50 million in assets. Fortunately for credit unions, the Democratic Congress declared the bill "dead upon arrival."

CUNA and NCUA had cooperated to the fullest extent with

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[240] "Pillars of Sand," Time Magazine, January 14, 1991, Vol. 137, Issue 2.

the forthcoming Government Accounting Office (GAO) study, hoping that it would highlight the healthy condition of the movement. They were more worried about the Treasury study of the regulatory and insurance system, since Treasury would be the source of any Bush administration banking legislation.

In the past, Treasury had favored consolidation of the regulatory and insurance agencies and switching credit union federal insurance to a system similar to what banks had. This would require credit unions to write off their one percent deposit with NCUSIF as an expense and thereafter pay annual premiums.

The so-called “double accounting” by which the one percent insurance deposit a credit union placed with NCUSIF could be counted as an asset both by the fund and by the credit union seemed to be the most vulnerable point in the credit union defenses.

The “double accounting” was in accordance with Generally Accepted Accounting Practices (GAAP), said the American Institute of Certified Public Accountants (AICPA).

But few credit unions ever got back their deposit by voluntarily going out of business and, as private insurance funds crumbled, there seemed to be little chance state-chartered credit unions would be leaving NCUSIF in any numbers and withdrawing their deposits. Since the insurance deposit was not available to credit unions under most circumstances, could it really be considered an asset?

Credit union lobbyists found much incomprehension about this issue among lawmakers and little support for it. “It’s political suicide to walk into your Congressman’s office and ask him to go along with (what he believes is) an unsafe system,” CUNA lobbyist “Sandy” Beach told the CUIS Newsletter, an independent publication.[241]

It was widely anticipated in Washington and by the credit union trade associations that the Treasury would recommend

[241] "The 1% Debate: CUNA’s Acceptance of Write-off Has CUs Fuming," CUIS Special Report, March 4, 1991, p. 3.

consolidation of the banking regulatory and insurance system—which, if it became law, would put credit unions under regulators more attuned to banks than financial cooperatives. It was also likely that the Treasury would recommend writing off the one percent NCUSIF deposit.

On January 3, CUNA's Chuck Zuver and Ralph Swoboda lunched at the Army/Navy Club in Washington, D.C., with Ken Robinson, the executive director of the National Association of Federal Credit Unions, and NAFCU chief lobbyist Bill Donovan. The four then met with NCUA Chairman Roger Jepsen and General Council Robert Fenner at the agency's offices to discuss legislative strategy and the Rhode Island crisis.

"It was over that lunch and during the meeting with Jepsen that the NAFCU people and we discussed the option of agreeing to a one percent write-off (of the credit unions' insurance deposit) over a period of time as a possible bargaining chip to get the other things we wanted from Congress," Swoboda recollected.[242]

On January 10, CUNA and NCUA received a phone call from Treasury Undersecretary Robert Glauber. He invited them to meet with him to get an advance peek at what Treasury was going to recommend in its study and proposed legislation. When they met, Glauber proposed a trade-off. Treasury would leave NCUA and NCUSIF alone if:

● One of the three NCUA Board seats were reserved for a representative of Treasury or some other federal financial regulatory agency and if:

● Credit unions expensed—wrote off—their one- percent NCUSIF deposit over a 12-year period. This was a longer period than provided in the Gonzalez bill and previously proposed by Treasury. In addition, credit unions would not have to pay bank-style premiums but would continue to contribute one percent of their insured savings growth each year, as they already did.

"The key part of the deal," Swoboda recalls, "was

[242] Note to author, November 24, 2004.

Treasury's assurance that credit union taxation would be off the table for as long as anybody currently at Treasury was still around."[243]

Glauber told NCUA and CUNA that the Treasury study was close to being completed, and asked them to let him know within two days whether they would support the proposed compromise.

For both NCUA and CUNA, the one percent deposit was secondary to preserving an independent regulator and insurance fund. NCUA agreed to the proposal. Swoboda called a telephone meeting of the CUNA Board, and the 35 directors unanimously approved the compromise, contingent on seeing the final legislative language and on banks' expensing their expected recapitalization of the Bank Insurance Fund. That same day, the compromise was endorsed by the league presidents at a separate meeting in Chicago.

Whether that two-day deadline CUNA was given was real or simply an attempt to exert pressure is unclear. It may have been a couple more days before Glauber approached NAFCU's Ken Robinson on the topic, with the hope that having CUNA in hand would put more pressure on NAFCU.

In any case, based on his conversations with NAFCU, Swoboda expected the other association would agree to the compromise proposal as well.

But NAFCU's membership included many of the largest credit unions in the nation with millions of dollars in the fund. When NAFCU's Robinson brought the idea before his board, it was soundly rejected. Tom Hughes of Navy Federal Credit Union almost came out of his chair and grabbed Robinson, the association's CEO remembered. Hughes was a a retired admiral. If Robinson hadn't been a retired general, Robinson laughed, there might have been a fight.[244]

CUNA well might have refused to agree to the Treasury proposal if it had known NAFCU would not follow suit. But it

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243 Personal communication with author, May 15, 2012.

244 Interview, October 7, 2004, CUNA Information Resource Center Archive.

had publicly announced its position before NAFCU's decision, and it was too late to retract without looking as if it was stumbling over its own feet.

Most leagues and credit unions fell into line with CUNA and its board's position, but there was vehement opposition in some quarters, especially among the larger credit unions. CUNA argued that the compromise made little practical difference to the movement – that it was a bookkeeping change not a financial change. (But as Swoboda told the author years later, he eventually came to realize that expensing the one percent contribution would have been a "material burden that would have hindered growth.")[245] Despite CUNA's arguments, it soon became clear that there was little enthusiasm for the proposal.

Meanwhile, the situation in the Middle East was taking the public's attention. U.S. forces and their allies on January 17 began bombarding Iraqi targets to prepare the ground for an attack to free Kuwait. President Bush authorized calling up as many as 1 million National Guardsmen and Reservists for up to two years.

Treasury's finished study was released February 5, 1991. In line with Glauber's proposal to NCUA and CUNA, it recommended consolidating bank and S&L regulation under Treasury. It left NCUA alone but with Treasury's proposed director of depository institutions sitting on NCUA's board. NCUSIF was also left alone, but Treasury recommended writing off the one percent deposit over a period of 12 years.

CUNA called this a victory for the movement, but also noted that it was only the beginning of the political process, expressing the aim of maintaining the one- percent deposit untouched. In other words, it was backing away from its support for a write-down.

In late February, 1991, credit unionists poured into Washington by plane, bus, train, and car. Some 3,500 attended the 1991 Governmental Affairs Conference (GAC), but in a "March on Washington," thousands more came from all

[245] Communication with author, May 15, 2012.

parts of the nation to join with the attendees in the planned rally on the Capitol Mall—a rally designed not as a protest but as a celebration of credit unions. Some brought their children to witness the historic gathering.

Enthusiastic credit unionists rallied at the Capitol in Washington, D.C. to show their support for the movement. (CUNA/Credit Union Magazine Photo)

The final day of the Governmental Affairs Conference and the day of the rally, February 28, dawned chilly and mostly

cloudy. A light breeze sprang up as the morning progressed—jacket and topcoat weather.

One of the participants, Mark Curran, remembered that day well.

"Thousands of credit union people were beginning to gather (at the U.S. Capitol). Each state's delegation had a sign identifying where they were from, just like you see at political party conventions . . . .

"All told, there were more than 15,000 enthusiastic credit union supporters on the grounds of the U.S. Capitol that day. There were speeches by CUNA executives and board members. Several politicians also addressed the crowd, pledging support for credit unions. They were clearly impressed by the sheer number of people who had descended on Washington to plead the case for credit unions."[246] Some 25,000 additional credit union supporters rallied in state capitals and other locations around the country.

At the U.S. Capitol, congressional aides and others emerged on the balconies to watch the rally. As it ended, credit union delegations fanned out from the Mall and delivered hundreds of bags of written petitions to the offices of their lawmakers, supporting the current regulatory and insurance arrangements and bearing some six million signatures by credit union members, officers, and staff. It was the largest number of petition signatures ever delivered at one time to Congress.

CUNA had hoped the rally would garner media attention, but that same day the Gulf War ended with Kuwait free and the Iraqi armed forces in shambles. This absorbed all the oxygen in the media, as the saying goes, though the Washington Times devoted a three-column spread to the rally. "It's hard to imagine (so many) people rallying on the Mall in support of their local bank," it said.

Although, media-wise, the rally had the Zen quality of one

[246] Curran, Mark, "This Feels Like Déjà Vu All Over Again," article for Filene Institute's "Crash the GAC" website, March, 2010.

hand clapping, the real target of the rally, Congress, was successfully alerted to the broad support credit unions enjoyed among voters. This, combined with letters and phone calls from credit unions across the country, helped make lawmakers sensitive to credit union concerns.

Treasury's proposal was incorporated into bills in the House and Senate. CUNA found reasons to withdraw its support entirely from Treasury's credit union plan.

The GAO submitted its report on banking to Congress in March and its credit union report in July. It recommended making the chairman of the Federal Reserve Board and the Treasury secretary ex-officio members of the NCUA board and having credit unions write off NCUSIF's one percent deposit. It also proposed eliminating the Central Liquidity Facility. While NCUA, along with CUNA, opposed these recommendations, the agency did begin adapting a number of GAO's regulatory recommendations.

In the end, Congress focused mainly on the banks, and the credit union provisions in its legislation were dropped, but not without intensive lobbying by the movement. The Financial Deposit Insurance Corporation Improvement Act (FDICA) recapitalized the Bank Insurance Fund through loans to be repaid out of future bank premiums. It tightened bank and thrift regulation.

The main provision affecting credit unions was the section called the Truth-In-Savings Act (TIS). This required depository institutions to use a standardized method for calculating the annual percentage yield (APY) they advertised to consumers. Previously, institutions employed a variety of ways to compute the interest on consumer savings, and by mandating a standardized APY, the new law made it much easier for consumers to compare the return on various savings instruments.

Credit unions had a good record of being open about how they calculated interest, and there were few consumer complaints about them. The movement worried that such legislation would take away its claim to be different from banks

and would lump it together with banks and thrifts in the minds of the public. Small credit unions argued they did not have the computer equipment needed to calculate the APY.

For several years, CUNA had worked to avoid being included in such truth-in-savings legislation through voluntary pledges made by credit unions to give their members full information about the terms of savings and how interest was calculated. But in the end, credit unions could not avoid being included in the TIS Act, and CUNA and NCUA could only provide credit unions with help and advice on how best to comply.

After the Grassroots rally, credit union influence in Washington was at an all-time high, outside observers reported, but more was involved in the Operation Grassroots victory than that.

CUNA's efforts benefited from the fact that the structure of Congress and the existence of powerful interest groups make it easier to block legislation than to pass it. Congress seldom passes major legislation unless there is an evident emergency, or great pressure from the public, or a fairly broad consensus of the various interest groups involved.

In the case of legislation like the Federal Deposit Insurance Corporation Improvement Act, the general public was largely out of the loop because of the technical issues involved. However, in addition to Treasury and the various regulators, at least 11 financial industry lobby groups were involved, as well as lobbyists the largest banks hired on their own. Each party had its own agenda and a number of them were at loggerheads with each other.

Without broad agreement among the players, Congress preferred to deal only with the most immediate issues and defer action on the others. This does not detract from the movement's achievement—without the impressive effort from credit unions, they well could have been affected much more strongly than they were in the final bill.

Chapter 41

CUNA Seeks Better Communication

The success of the war to liberate Kuwait sent President Bush's popularity soaring, but the ongoing recession dragged it back down. In 1992, in a race complicated by the independent candidacy of eccentric billionaire Ross Perot, Democrat Bill Clinton of Arkansas defeated Bush's reelection bid.

Clinton billed himself as a "new Democrat" who would steer a middle course between free market principles and the traditional welfare state policies of his party.

He started reducing the federal deficit by persuading Congress to raise taxes on the wealthy and on gasoline, while at the same time Congress restrained spending. He persuaded the Senate to free up trade by ratifying the North American Free Trade Agreement (NAFTA) and completed negotiations on the General Agreement on Trade and Tariffs (GATT).

Meanwhile, CUNA was looking at its relationship with its member leagues and with their affiliated credit unions.

The furor over CUNA's support for expensing credit union contributions to NCUSIF had threatened to split the movement. To CUNA President Ralph Swoboda, it meant that the organization needed to involve credit unions more deeply in its deliberations and activities.

The leagues, as the members and owners of CUNA, traditionally acted as gatekeepers between CUNA and the credit unions. The leagues had to give their permission for CUNA to communicate directly with league members or offer services to them.

In 1988, CUNA had begun a series of Opinion Barometer Surveys that probed credit union views, mostly on non-controversial issues. Such a survey in 1992 of 1,900 credit union CEOs asked if CUNA accurately represented credit union management and volunteers. Twenty percent of those responding agreed strongly. Fifty percent agreed somewhat. Twelve percent disagreed, and 18 percent had no opinion or didn't know.

CUNA began looking for way to communicate more effectively with credit unions and feel the movement's pulse.

CUNA from its founding had sent its monthly Credit Union Magazine to all credit unions affiliated with its member leagues.[247] And in 1982, after getting permission from the leagues, it had converted its Leadership Letter— which went to elected CUNA and league officials—into the weekly newsletter Credit Union Newswatch, which was mailed directly to credit unions.

The fast-evolving world of electronic communications now offered a way to communicate more rapidly with the movement. By 1991, a daily electronic version of Newswatch, Credit Union News Now, was being e-mailed to leagues and some 600 credit unions taking part in CUNA's Meteor electronic computer network, a dial-up holdover from the mostly defunct Credit Union Internet.

The "real" Internet was opened to commercial use in 1991, and the World Wide Web, which permitted uploading pictures and sounds as well as words, was coming into use. Eventually, the Internet succeeded Meteor as CUNA established a web page. This would link the whole system electronically as CUNA's former CEO Jim Williams had sought to do earlier.

But this still left no organized and timely way for credit unions to express their opinions directly to CUNA.

The controversy over the one percent compromise "made me realize that the structure we had was not appropriate for the role (CUNA) was serving," recalled Ralph Swoboda.

"The position of our member leagues all along was, well, they were really the spokesmen for the credit unions. And (the elected CUNA Board and Executive Committee) provided all we needed to know about the credit union community."

Two ways of addressing this problem of involving credit unions were developed by Swoboda in the early 1990s. One was open committees. Ordinarily, CUNA committees on various issues were appointed by the CUNA chairman and consisted of

[247] Credit Union Magazine was known as "The Bridge" in its early days.

members of the board. The chairman could also enlist others in the movement on task forces to study particular issues.

Open committees, in contrast, were open to any credit union willing to take part (and pay the expenses of attending). One of the first to be formed was the Bankruptcy Open Committee. While the committee focused on legislative measures, it also encouraged more financial counseling of members, education of members and credit unions about bankruptcy, cooperation with Consumer Credit Counseling Services (CCCS), education of credit unions, especially smaller ones, about dealing with bankruptcy filings by members, and better lending practices. Experience would show that such measures were more effective in combating bankruptcy losses than legislative remedies.

The CUNA Councils were the second innovation. As credit unions grew larger, more and more decision-making was flowing into the hands of middle managers rather than CEOs. These middle managers often had little contact with the leagues or CUNA. They tended to identify more with others in their profession than with the Credit Union System as such. There was some thought among them that they should be forming their own associations that would not be integrated with the Credit Union System.

One reason for CUNA and league concern over this situation was that middle managers felt little loyalty to products and services offered by System vendors. Both CUNA and the leagues wanted to find ways to communicate better with them. But it is also true that CUNA and the leagues felt that these professionals had valuable knowledge to contribute to the System.

The aim of the councils was to integrate these middle managers more closely into the System, giving them a voice and "ownership," opportunities for training, and a convenient way to network with their colleagues.

The first council was formed almost by accident. Credit union marketers had an association tied in with the Credit Union Executives Society (CUES)—an offshoot of CUNA that

now operated independently. CUES decided to abandon its sponsorship of the Financial Marketing Association, as it was called. In 1993, CUNA stepped up to support the group, which became the CUNA Marketing Council (now CUNA Marketing and Business Development Council.)

Five other councils were added over the following years in the area of finance, human resources, lending, operations, and technology. Each council is a democratic organization in charge of its own affairs but receives administrative support from CUNA.

Chapter 42

Problems with the Regulators

NCUA had managed to retain its independence and its separate insurance fund. But it knew it was under scrutiny from Congress as banks and savings and loans went under in the recession of the early 1990s. It stepped up its oversight of federally insured credit unions by adding 62 new examiner positions. (Federally insured state charters were usually examined by their state regulatory agencies.)

While most credit unionists welcomed tougher scrutiny, CUNA and the leagues started getting more complaints from credit unions about their examinations.

A CUNA survey showed that the most common complaints were "incorrect findings due to examiner error" and "new standards applied retroactively." The top criticism of federal examiners was "surprises at the exit interview with the board." But on the whole, examiners ranked high in such areas as courtesy and professionalism.

NCUA responded to the survey by showing itself ready to work with the movement to improve the examination process. "The golden rule is that we're not going to be playing 'gotcha,'" said Allen Carver, NCUA's Region III director. "We're not going to try to sit down and body slam people. We're going to treat

credit union officials as we would like to be treated as credit union officials."[248]

NCUA and state regulators were not the only regulators credit unions had to worry about. Some 109 federal laws and regulations affected credit unions, covering such diverse areas as hiring and money laundering.

A CUNA survey found that the average credit union spent some $43,500 a year to comply with federal regulations—not including safety and soundness require-ments and those imposed by NCUA.

While smaller credit unions spent less than this average, they still found compliance a major burden, amounting to some 13 percent of operating costs for credit unions under $2 million in assets. The comparable share of operating costs for the average credit union above $200 million in assets was one percent. The regulatory burden on small credit unions obviously was a factor driving mergers.

Tensions over regulation grew when Roger Jepsen's term as NCUA chairman ended in 1993. President Bill Clinton replaced him with a former Democratic Congressman, Norman D'Amours.[249] D'Amours hired former CUNA lobbyist Karl Hoyle as NCUA's executive director.

Coming from New Hampshire, where the U.S. credit union movement began, D'Amours had been a longtime credit union supporter. He had been applauded by the movement in 1983 when he led a House petition drive to spring loose from the Ways and Means Committee a bill repealing the recently enacted law requiring financial institutions to withhold part of depositors' interest income on behalf of the IRS. The industry, including credit unions, had fought this measure as costly and unneeded.

But in contrast to Jepsen, who was well-liked by nearly

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[248] "NCUA Regional Directors Face Constituents," Credit Union Magazine, April, 1992, p. 28.

[249] D'Amours preferred to have his name pronounced in the French manner, without sounding the "s."

everyone who met him, D'Amours wound up alienating many in the movement and even his fellow board members.

He came to his office with several beliefs: that larger credit unions were drifting away from their mission of serving people of modest income, that professionals in the movement were usurping the powers of board volunteers, and that the trade associations, especially CUNA, had too much control over the credit union movement.

Five years after he left his post at NCUA, D'Amours would spell out his beliefs in testimony before the House Ways and Means Committee:

"In my opinion, the majority of credit unions are holding true to their mission of focusing on low-income members and potential members. However, this majority controls a relatively small minority of the total assets of the credit union system, and this majority has little or no voice in setting the direction and priorities of the overall direction of the credit union system. The founders of the credit union movement insisted that unpaid volunteers would control a not-for-profit system, run on sound business principles by people who were not out for personal enrichment, and who would focus on low-income Americans.

"The reality today is that a small minority of large credit unions have created a tightly-controlled and intimidating structure, controlled not by volunteers, but by professionals who pursue growth for its own sake, and who profit quite handsomely from that growth. Those in control are uncomfortable with, and even at times in denial of, the traditional credit union obligation to focus on low-income people. They fear there is just not enough profit in that."[250]

Some in the movement believed D'Amours' attitude toward the trade associations was reinforced by his executive director, Karl Hoyle, who, they said, bore a grudge against CUNA and the leagues as a result of former CUNA President Jim Williams'

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[250] Review of Credit Union Tax Exemption: Hearing before the House Ways and Means Committee, 109th Congress, First Session, November 3, 2005, Serial Number 109-38.

departure from the trade association. However, in an interview with the author, Hoyle denied any ill will toward CUNA and the leagues.[251]

In D'Amours' defense, the new chairman came into the office with the example of the S&L industry's implosion hovering like a ghost at the feast. That industry's political power and effective trade organization had enabled it to avoid strong regulation, which contributed to its downfall when hard times came. D'Amours knew Congress would be looking over his shoulder.

Reasonable arguments could be made for each of D'Amours' positions, but a lack of tact and often abrasive approach turned away many in the movement. The relations between D'Amours and the organized movement would grow so stormy that some would call for his removal.

Chapter 43

Corporates Become An Issue

Much of the tension in the early days of D'Amours' administration centered on the corporate credit union system. The corporate system had grown in an unorganized fashion through the 1960s and early 70s, responding to state and regional needs. Its primary function was to be a source of liquidity—i.e., providing funds for credit unions to borrow when necessary to meet loan demands and to provide a safe place for credit unions to invest surplus funds.

As noted earlier, the organization of U.S. Central Credit Union in 1974 by CUNA and the leagues helped tie together

[251] Hoyle, Karl, Interview, March 17, 2005, CUNA Information Resource Center Archive. Somewhat ironically, in view of the strained relations that developed between D'Amours and CUNA, he had been a political consultant to CUNA following his reelection defeat in 1984. After Karl Hoyle left as CUNA's chief lobbyist, the association's new president, Ralph Swoboda invited D'Amours to take his place, but, as Swoboda recalls, the ex-congressman declined because he planned to run again for office and was afraid being a lobbyist would ruin his election chances. Chuck Zuver then was chosen to succeed Hoyle. (Personal communication with author, May 15, 2012.)

these disparate institutions into what became known as the Corporate Credit Union Network (CCUN). U.S. Central served as a central bank, or banker's bank, to the network by meeting the liquidity and investment needs of corporates.

U.S. Central was governed by a board consisting of corporate, league, and CUNA representatives, and it contracted with CUNA to provide management services. U.S. Central's on-site manager in Overland Park, Kansas, reported to CUNA's president in Madison, Wisconsin.

The assets of the network grew steadily, from less than a billion dollars to some $2.5 billion in 1980. In late 1980, U.S. Central and the corporates began developing a range of wholesale financial and payment system services, such as share draft collection and processing, to provide to their members.

From 1980 to 1994, deposits in the Corporate Network rose to some $28.3 billion. The CCUN, however, was still something of an ad hoc organization with disparate goals.

Slightly more than half of the corporates were linked with league management, that is, they were "integrated" with the leagues in their respective states. The league president either was president of the corporate, or the corporate head reported to him or her.

These credit unions tended to operate conservatively. They followed a "matched book" investment strategy—investing most of their funds in U.S. Central, which reinvested them in very safe instruments that closely matched the rates and maturity of the underlying obligations to member credit unions. This ensured that corporates always had plenty of cash on hand to meet withdrawals by member credit unions. Because credit union needs for funds varied with demand for loans, the assets of these corporates tended to rise and fall in response to economic conditions.

The rest of the corporates were independent and not necessarily cooperative with their local leagues, although nearly all the credit unions they served were league members.

These corporates tended to operate more aggressively than the integrated ones, seeking higher returns for their members. Using what was called a "managed book" strategy, they did achieve higher returns as a group—averaging a yield of 4.79 percent of assets at year-end 1994 vs. 4.42 percent for integrated corporates.[252]

But this left them more exposed to various risks that needed specialized expertise to be carefully managed. In particular, most of the non-integrated corporates (but only a few of the integrated ones) were investing in complicated securities known as collateralized mortgage obligations (CMOs).

CMOs were one of a fast-growing variety of financial instruments called derivatives that took their value from an underlying asset.

CMOs were invented in 1983 by investment banks Salomon Brothers and First Boston to provide a way for government sponsored mortgage agencies like the Federal Home Loan Mortgage Association (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) to fund the mortgages they bought from mortgage lenders. The underlying asset for each CMO was a pool of home mortgage loans that earned a return as their principle and interest were repaid. These mortgage pools were "packaged" by the investment bankers into CMO bonds sold to investors..

Most CMOs at this time were "agency CMOs" whose underlying mortgages met the standards of the government-sponsored mortgage agencies, who guaranteed their repayment. These were considered the safest form of CMOs—nearly as safe as U.S. Government bonds. But other CMOs sold to investors were created out of so-called "non-conforming" mortgages that did not meet agency standards. These CMOS were often structured to include "credit enhancers" (such as insurance against default), but they were not considered nearly as safe an investment.

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[252] "Summary of Corporate Comparisons as of December 31, 1994," CUNA, February 28, 1995, Ralph Swoboda personal papers.

Ordinarily, the cash flow generated by the mortgages in a CMO was split into three (or more) payment streams called "tranches," a French word meaning slice or trench. They were designed so that each tranch paid a progressively higher rate but at the expense of carrying a progressively higher risk.

These tranches received ratings from the national ratings agencies (e.g., Moody's, Standard and Poors, and Fitch). The lowest tranche, called the junior or equity tranche, bore the burden of any losses in the underlying mortgages and carried the lowest rating and the highest risk. The buyer of that tranche received the highest return to compensate for the extra risk. The next tranche, called the mezzanine tranche, carried a somewhat lower level of risk, absorbing losses not absorbed by the junior tranche, and the return was somewhat lower as well. The lowest-risk tranche was called the senior tranche. It had the highest rating and lowest return and was considered the safest.

We have spelled out the CMO structure in some detail because these bonds foreshadowed the more elaborate investment vehicles that would play a major role in the economic meltdown of late 2007. The marketing and purchasing of CMOs and other investment vehicles had ballooned rapidly after 1980, and, like the money market mutual funds, the agencies and firms that traded them were becoming a growing part of the "shadow banking system."

CMOs, especially senior tranches, were considered safe investments from the point of view of "credit risk" because it was believed home owners would go to great lengths to avoid default on their loans. An agency CMO carried even less credit risk because it was backed by Fannie Mae or Freddie Mac. But all CMOs carried considerable "interest rate risk." that needed to be managed carefully, since the value of any tranche could fluctuate sharply as interest rates rose or fell. If a corporate credit union were forced to sell at an unfavorable time, it could take a loss on the sale.[253]

[253] As the General Accounting Office (GAO) put it in a 1995 report to Congress on Capital Corporate Credit Union, "The market value of a CM0 tends to be more volatile than traditional corporate investments – such as

The integrated corporates had an average of 15 percent of their assets invested in CMOs (mostly concentrated in two or three corporates), but the average for non-integrated corporates was 31.4 percent. This did not necessarily mean greater risk per se if carefully managed, but not following a matched book strategy meant the corporate might not be able to handle large withdrawals if interest rates went up.

The less-integrated corporates also averaged slightly less capital as a cushion against losses than the integrated ones – with Tier 1 capital averaging 2.36 percent of assets at the non-integrated corporates and 2.53 percent at the non-integrated.[254]

Integrated and non-integrated corporates had divisions within their own ranks. Each group had a handful of large corporates above $1 billion in assets, with many of the remainder being relatively small.

The largest of the non-integrated corporates was California's WesCorp with $12.4 billion in assets. Among the integrated corporates, the biggest was Southwest Corporate in Texas, with nearly $4 billion in assets.

The large corporates, like large natural person credit unions, tended to be more self-sufficient than their smaller counterparts. They could offer a wider range of services to member credit unions.

The large corporates also often operated in several states or nationally and thus provided competition to smaller corporates

U.S. Treasury obligations – in part because changes in interest rates affect the time pattern of mortgage repayments. When interest rates rise, people repay mortgages at a slower rate and the average maturity of these assets lengthens." As a result, holders of these bonds have to wait longer for their return and the market value of the CMO falls.

[254] Tier 1 capital, also known as core capital, consists of reserves and other financial assets that represent a depository firm's most reliable cushion against losses – the more Tier 1 capital, the more resilient the firm can be in dealing with losses. Corporates also had Tier 2 capital – consisting of Membership Capital Share Deposits (deposits that earned a higher rate of return than regular deposits but which could be withdrawn by members with appropriate notice and thus did not provide as firm a backstop against losses.)

that confined their operations to a single state. The large corporates were growing faster than their smaller counterparts. Smaller corporates were forming partnerships or merging with their bigger brethren.

And the larger corporates increasingly were investing more of their deposits outside U.S. Central, while some large credit unions, in turn, wanted to bypass their corporates and deal directly with U.S. Central.

Each faction—integrated and non-integrated corporates, large and small corporates, and large credit unions—had its own needs and presented different requirements for the capstone institution serving them – U.S. Central Credit Union.

There were still other actors in the corporate drama: The leagues that shared management with integrated corporates. The Association of Credit Union League Executives (ACULE), which maintained an active role in the corporate system through its seats on the U.S. Central Board and ACULE's Corporate Forum that provided a place for integrated and non-integrated corporates to discuss issues. And CUNA itself which managed U.S. Central under the CUNA and Affiliates umbrella.

As a result of the tug-of-war among these elements, there was growing stress in the corporate network. U.S. Central was the place where fault lines intersected.

"An uncomfortable feeling between the staff and management of U.S. Central and the corporates persisted through most of the 1990s," according to the late corporate pioneer and historian John H. Arnold. The diverse membership led to "intense planning as well as operational problems . . . . The system continued to run in circles, the decision process was too elongated, and opportunities were missed."[255]

This complex and stressed system had been under scrutiny for some time from within and without the movement.

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[255] Arnold, John H., *The Journey: A History of the Corporate Credit Union Network*, 2001, The Association of Corporate Credit Unions, Kendall/Hunt Publishing Company, Dubuque, Iowa, p. 133.

ACULE's Corporate Forum in the 1980s had developed safety and soundness standards for corporates, but these were voluntary and difficult to enforce. A Forum committee began updating the standards in 1989, but it could not find consensus as the early 1990s passed.

A CUNA committee in 1993 acknowledged that there was a lack of "shared vision" in the movement regarding the functions and mission of the Corporate Network. [256] And a study commissioned by the California, Texas, and Oregon leagues saw potential conflicts of interest when the membership of the U.S. Central Board was weighted toward the leagues and CUNA. [257]

U.S. Central itself was looking at the future of the Corporate Network. In August, 1994, the U.S. Central Board met for a planning session to address issues crucial to the future of the Corporate Network. The result was a "New Strategic Direction for U.S. Central" proposal. Among other things, it called for focusing U.S. Central on its core mission of providing loans and supporting services to its corporate members, rather than competing with them to provide services to large natural person credit unions.

An example of U.S. Central's service to natural person credit unions was Corporate Network Brokerage Services, Inc. (CNBS), which enabled them to obtain investment products without going through their corporates. U.S. Central held 70 percent of CNBS stock. The other shareholders were CUNA Mutual and CUNA.

The decision to retreat from such services meant, in practical terms, divesting U.S. Central's share of CNBS because it was causing distrust between the corporates and U.S. Central.[258]

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[256] System Structure Planning Committee.

[257] Barth-Brumbaugh Study.

[258] U.S. Central Credit Union Membership Dialogue Session and Presentation by Chuck Purvis, October 10, 1994, personal papers of Ralph Swoboda.

Then there was Congress, always a looming presence for the credit union movement. At Norman D'Amours' confirmation hearing in late 1993 before the Senate Banking Committee, the former Congressman was exposed to the trauma many lawmakers had developed over the savings and loan and banking problems. To his surprise, he told the author, many questions focused on the condition of the corporate credit union system. He promised the committee that as chairman he would appoint a group to study the corporate system and its regulation.

Chapter 44

Banesto Sets Off Furor

In late December, 1993, less than 60 days after D'Amours took office, the Spanish government suspended trading in the stock of the troubled Banco Espanol de Credito—more commonly known as Banesto—and removed its executives because of a massive internal fraud.[259] The central bank of Spain guaranteed Banesto's obligations.

U.S. Central Credit Union had $255 million invested in Banesto's short-term debt, an amount that greatly exceeded the corporate's capital. U.S. Central was proud of its triple A credit rating. The Banesto investment resulted from U.S. Central's policy of limiting its investments in bank obligations to those of very large and highly rated banks—banks considered to be "too big to fail." In the early 1990s, there were only a handful of U.S. banks that fit that definition (not enough to satisfy U.S. Central's diversification requirements), so its list of approved institutions included some foreign banks like Banesto.[260] However, unknown to the Spanish authorities and

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[259] Banesto was best known in the U.S. as a sponsor of Spain's "Big Mig," Miguel Indurain, who during this period was becoming the first cyclist to win the Tour de France five times in a row.

[260] Since U.S. Central took no foreign currency risks, it required these "foreign bank" investments to be denominated in U.S. dollars. The Banesto investments were issued by Banesto's branch in New York City, which was supervised by the New York State Banking Department.

the rating agencies, Banesto's financial condition had been deteriorating for some time before U.S. Central placed its money there.

In the wake of the seizure, the Spanish government assured U.S. Central that its investment would be repaid on time, and it was. No money was lost. But the idea that corporate credit unions were invested in foreign banks at all was disturbing to many lawmakers.

NCUA scrambled to respond to the concern. The board called officials of U.S. Central to Washington to explain their investment in Banesto.

Seizure of Banesto caused political problems for the corporate credit union system and NCUA. (Bigstock Photo)

NCUA requested a voluntary moratorium on all corporate foreign investments while it reviewed the issue. Since most investments, like the one in Banesto, were short-term, total foreign investments dropped from about $10 billion as of December 31, 1993 to less than $300 million over the following

year. Eventually, limited foreign investments would resume with NCUA's approval.

NCUA's Regulation 704 dealt with corporate credit unions. It had been strengthened in 1992, incorporating a number of recommendations in the 1991 GAO report on credit unions. Since that time, NCUA Chairman Jepsen had tried to work cooperatively with the movement in the corporate area. Shortly before his term ended in 1993, he urged the Corporate Forum to finish updating its voluntary safety and soundness standards.

As noted above, D'Amours' attitude toward the organized movement was more confrontational. Following the Banesto affair, he met in February, 1994, with a group of corporate managers. His first words were, "I am the regulator; you are the regulated." They quickly grasped that D'Amours wanted to avoid even the appearance of being influenced by those he regulated.[261]

While the credit union movement had had its share of mishaps, it was proud of its long history of solving its own problems. D'Amours' spare-the-rod, spoil-the-child approach raised hackles in people accustomed to dealing with Roger Jepsen.

As he had promised during his nomination hearing, D'Amours in March, 1994, appointed a five-person committee to study the corporate system, headed by Harold A. Black, a professor of finance and a former NCUA board member,

The following month, even before the committee had finished its work, NCUA proposed amending Regulation 704 to break the management ties between leagues and corporates, and between CUNA and U.S. Central. The Black committee's final report concurred. While some credit unions, especially larger ones, supported NCUA's position, the general movement reacted strongly against it.

CUNA and the leagues argued that integration was not a

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[261] Arnold, John H., *The Journey: A History of the Corporate Credit Union Network*, 2001, The Association of Corporate Credit Unions, Kendall-Hunt Publishing Company, Dubuque, Iowa, p. 123.

safety and soundness issue—indeed, that integrated corporates tended to be more risk-adverse than non-integrated ones, because they were less concerned about the natural ebb and flow of funds into their coffers as the liquidity needs of member credit unions changed with loan demand.

As CUNA President Swoboda said in a letter to Senate Banking Committee Chairman Alfonse D'Amato (R-NY), "The chief executive officer of a league-related corporate is usually a league president. The operation of the corporate credit union is only part of this individual's responsibilities. He or she is also in charge of the state trade association and other service affiliates.

"He or she has little opportunity for personal gain based on the size of the corporate, but faces considerable risk should a corporate fail. As such, increases or decreases in the size and scope of the league-related corporate credit union are less significant than they are to the CEO of a stand-alone corporate, who has no other responsibilities (and thus may take on more risk in an effort to grow the corporate)."[262]

Any irregularities due to corporate interlocks at worst were minor and could be dealt with under the existing Regulation 704, CUNA argued. The movement viewed the interlocks proposal as regulatory overreach threatening the freedom of the movement to organize itself in the most efficient way possible.

But to NCUA, the interlocks represented something more basic. As NCUA General Council Robert Fenner recalled to the author many years later, he felt very strongly that the control by CUNA and other trade associations of corporate credit unions was an inherent conflict of interest, and that the control needed to be broken.[263]

D'Amours told the author than he was surprised by the

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[262] Letter to D'Amato submitted for the record in the committee's hearing March 8,1995, on the failure of Capital Corporate and the state of the Corporate Network. Personal papers of Ralph Swoboda.

[263] Fenner, Robert, Interview, December 17, 2004, CUNA Information Resource Center Archive.

intensity of opposition in the movement to the interlocks proposal. He compared it to a child resisting having a lollipop taken away.[264]

To try to defuse the situation, CUNA renounced its managerial role in U.S. Central. U.S. Central President Jim Bell would no longer report to CUNA and Affiliates President Swoboda. However, Swoboda remained on the board, and the board remained heavily weighted toward CUNA and the leagues. The announcement of the change was made at CUNA's 1994 Annual Meeting in Kansas that October.

It was customary to have the NCUA chairman speak at CUNA annual meetings, and 1994 was no exception, except for the tone of the reception given the new chairman. D'Amours was greeted with hisses and angry remarks from league representatives—it was very strange, he told the author 10 years later.[265]

"Your regulation is tearing down a system built by honest, hard-working people," South Carolina's League President Tommy Delk scolded as the audience erupted into a standing ovation.

Despite the opposition of the organized movement, in November, 1994, the NCUA board in a 2-1 vote issued a final rule dealing with the recommendations proposed by the Black committee, including a ban on interlocks. The rule was to go into effect in 1996. Chairman D'Amours and Vice Chairman Shirlee Bowné voted in favor. Robert Swan, the only board member with actual credit union experience, voted against it.

"While management decisions in the majority of the interlocked corporate credit unions are above reproach," D'Amours told a House banking subcommittee, "the fact remains that we have encountered specific situations of abuse in some corporate credit unions that are directly attributable to the interlock of the boards of directors of the corporates with the boards of directors of other credit union related

[264] D'Amours, Norman, Interview, November 15, 2004, CUNA Information Resource Center Archive.

[265] Ibid.

organizations and the serious conflicts of interest that result.

"Such actions can only threaten stability and member confidence in all credit unions." [266]

Among other things, the rule required that:

● a majority of a corporate's directors, including the chairman of the board, be individuals who represented member credit unions and were not officers, directors, agents, or employees of the same credit union's trade association or an affiliated association;

● election procedures use mail ballots and nominations by petition;

● the chief executive officer of the corporate answer solely to the board of directors of the corporate credit union (some corporate CEOs answered directly to the state league CEO, while others served as CEO of both organizations and thus answered to the league board); and

● membership in the corporate credit union could not be conditional upon a credit union's affiliation with another organization, i.e. the league.

NCUA and the organized credit union movement actually were not far apart on their ideas about how to ensure the safety and soundness of the corporate system.

All agreed that the credit union movement in general and the corporate network in particular were healthy. All agreed that to maintain safety and soundness tighter corporate regulations were needed. They agreed that corporates should generally follow a matched book strategy rather than reaching for maximum returns.

The main area of disagreement was over the hot-button interlocks issue. CUNA used its testimony to Congress to emphasize its position that corporate interlocks, by themselves, were not a safety and soundness issue.

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[266] D'Amours, Norman, Testimony Before The Subcommittee On Financial Institutions And Consumer Credit Of The Committee On Banking And Financial Services, U.S. House Of Representatives, February 24, 1995

Of the 800-some comment letters from credit unions regarding NCUA's proposed rule against corporate-league interlocks, around 70 percent opposed it.

CUNA was determined to try to defeat the interlocks proposal. It twice asked NCUA under Freedom of Information rules to provide the examples of misconduct the agency claimed made the rule necessary. When NCUA refused, CUNA, the Virginia League, four corporates, three individuals, and one natural person credit union filed a suit against the interlock ban on February 3, 1995, in the U.S. District Court for the Eastern District of Virginia.

"A lawsuit is the only recourse left to force the agency to produce its evidence," CUNA President Swoboda said. CUNA argued in the suit that NCUA had not demonstrated any threat to safety or soundness from interlocks, failed to comply with important procedures, and acted beyond the scope of its authority. The National Association of State Credit Union Supervisors (NASCUS) joined the suit, arguing the rule infringed on the powers of the state to regulate state-chartered corporates.

Chairman' D'Amours' address at CUNA's Governmental Affairs Conference in late February, 1995, was the usual mixture of conciliatory remarks and admonitory lecture. He again praised the role of volunteers and accused the movement of drifting away from its mission:

"We at NCUA do not want to over regulate you. The opposite is true. We tell our examiners to allow flexibility and not overly focus on ratios like delinquencies and charge-offs or additions to reserves and to stop limiting mortgage loans. I hope credit unions stop chasing CAMEL ratings. I also hope we can eliminate regulations that are wasteful.

"On the other hand, I hope no one expects NCUA will forget safety and soundness or forgets that we are charged with protecting the credit union mission. Credit unions are not banks and we are not bank regulators. NCUA has a special mission, not only to protect safety and soundness but also to focus on the statutory and historical mission of the system.

"Congress gave that responsibility to NCUA at the strong urging of Edward Filene and Roy Bergengren and others who loved the credit union movement. If we at NCUA abandon that responsibility, as some are urging, we will lose the public and Congressional support without which we can't operate as an untaxed, special system with an independent regulator."[267]

At the same conference, a small group of credit union leaders including CUNA's President Swoboda met for dinner with a senior adviser to President Clinton to discuss their dissatisfaction with the NCUA chairman. As the aide entered the room, he joked, "I take it this is not the D'Amours fan club." "No, that would be an even smaller group," replied Dave Chatfield, former NCUA board member and president of the California League.[268]

The dinner led nowhere but discussions continued as to how to get D'Amours out of the chairman's post or at least dilute his authority.

Suggested solutions ranged from persuading Congress to impeach him to supporting Republican Senator Phil Gramm of Texas in the next presidential election as a way to call attention to problems at NCUA.

The outcome of this discussion was that CUNA promoted legislation to expand the three-person NCUA Board to five persons, to reduce the chairman's power and give the board a broader perspective. Some other financial regulatory bodies such as the FDIC had five-member boards, and the Government Accounting Office in 1991 had recommended the same for NCUA.

Under CUNA's plan, one NCUA board position would go to a representative of federally insured state-chartered credit unions. Senator Phil Gramm (R-Texas) and Representative Bob Barr (R-Georgia) introduced bills to this effect. NCUA opposed the idea, and the measures failed to win support.

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[267] D'Amours, Norman, Remarks before the Credit Union National Association Governmental Affairs Conference, February 27, 1995.

[268] This story was related to the author by Ralph Swoboda on September 9, 2010.

The heat under the simmering interlock pot was turned up in March, 1995. U.S. Central President Jim Bell had been under pressure for some time due to an illness in his family, the tensions within the Corporate Credit Union Network, the Banesto affair, the dispute with NCUA over interlocks, and what he regarded as interference in U.S. Central operations from CUNA and the leagues. He had talked about resigning.

During a contentious meeting of the U.S. Central Board to discuss the future of Corporate Network Brokerage Services, Bell abruptly submitted a resignation letter to Chuck Whitney, chairman of the board.

In his letter, Bell said, "the intense political turmoil surrounding U.S. Central has reached the point where the company is approaching instability, if it is not already there." Among factors he cited was "the war between CUNA and NCUA declared over the issue of trade association control of corporates."[269]

Bell apparently did not plan on his letter becoming public, but it did. In an interview about his resignation with the American Banker trade newspaper, he said he hoped the trade association's suit against NCUA would fail.[270]

CUNA's Swoboda sent out a response arguing that the real issue was not political but the contending expectations of U.S. Central's members. "Despite Jim's departure, I'm confident that U.S. Central's management team, composed of very strong and competent individuals, are up to the challenge of managing U.S. Central during difficult times . . . . The pressures (U.S. Central) faces are in the area of member relations and do not affect its safety and soundness."[271]

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[269] Letter from James R. Bell, president, U.S. Central Credit Union, to Charles Whitney, chairman of the board, U.S. Central Credit Union, and president New York State Credit Union League, March 9, 1995, attached to letter of President Swoboda to CUNA/CSG Board, March 21, 1995. Information Resource Center Archive, Box 245605(3).

[270] "U.S. Central President Quits; Says Trade Group Meddles in Management," American Banker, March 20, 1995.

[271] Statement From CUNA President Ralph Swoboda Regarding Jim Bell's Resignation Letter, March 20, 1995, Ralph Swoboda papers.

One result of CUNA's suit was that NCUA did finally reveal two cases of misconduct supposedly due to corporate interlocks. One situation related to the corporate in Puerto Rico, which also performed league functions and was seen by CUNA as irrelevant. The other pre-dated NCUA's 1992 revisions to its corporate rule, which CUNA said effectively dealt with the kind of situation cited.

CUNA called on NCUA to settle the suit by revising its regulation to allow corporate credit union members to elect league officials to their corporate's board. NCUA refused.

But CUNA found itself under intense pressure to abandon the suit when Pentagon Federal Credit Union, the nation's third largest credit union, quit its membership in the Virginia league and corporate as a protest and called on other large credit unions to follow its example. The board of Navy Federal Credit Union, the nation's largest, voted to end its Virginia league membership, although it remained with the corporate.

There were few more defections, however, and CUNA pursued the suit until in September, 1995, the District Court ruled in favor of NCUA. The court found that NCUA had ample factual basis to conclude that the rule was necessary, that the agency had acted within the scope of its authority, and that NCUA did not act in an arbitrary and capricious manner. At that point, CUNA decided not to appeal. An appeal by the National Association of State Credit Union Supervisors (NASCUS) failed.

NCUA did make some revisions in the rule in 1996 and put it out for public comment, but it did not rescind the ban on interlocks with leagues. The final rule was approved later that year and went into effect in 1997.

Chapter 45

NCUA Seizes Capital Corporate

In the midst of this wrangling, some collateralized mortgage obligation (CMO) chickens came home to roost. In 1994, several corporate credit unions ran into financial

difficulties as rising interest rates caused the value of their CMO holdings to lose value. Hardest hit was Capital Corporate Credit Union (CapCorp).

Capital Corporate Credit Union had been chartered nearly 20 years. It had taken over the membership of the liquidated NAFCU Corporate. Its primary field of membership included credit unions in Washington, D.C., Maryland, and Delaware, but it also had a nationwide charter for federal credit unions, and in recent years it had aggressively pursued business around the nation.

"The only real marketing tool CapCorp had to attract business away from local corporate credit unions was higher investment rates. The only way to provide higher rates was to take on additional investment risks," noted U.S. Central President Jim Bell in testimony before Congress.[272]

As a result of its strategy, CapCorp had grown to become the second largest of the corporates not integrated with a league, with some $1.5 billion in assets.

CapCorp had always been very much a lone player. "It had a long history of acting independently and not recognizing the importance and value of the interdependent relationships available in the (corporate) network," according to corporate credit union historian John H. Arnold.[273]

CapCorp had signed the Corporate Forum's Standards and Guidelines. But it refused to sign updates being circulated by the Forum, though it said it would abide by them.

As early as 1989, NCUA ranked CapCorp at CAMEL 3 and required it to "stress test" its CMO portfolio to evaluate its vulnerability to interest rate changes.

CapCorp acquired a stress test model in 1992. That same

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[272] Written Statement of James R. Bell, President, U.S. Central Credit Union, to the U.S. House of Representatives and Senate Banking Committees, February 24 and 28, 1995.

[273] Arnold, John H., *The Journey: A History of the Corporate Credit Union Network*, 2001, The Association of Corporate Credit Unions, Kendall-Hunt Publishing Company, Dubuque, Iowa, p. 120.

year, it departed from a matched book strategy and began seeking higher yields. But it failed to consistently test its CMO purchases or document the tests.

Although NCUA gave CapCorp a CAMEL 1 rating in 1992, the examiner noted that its CMOs had not been stress-tested and that it lacked an adequate Asset-liability modeling capability.

The corporate's board and senior management agreed to address NCUA's concerns, but they did not do so, and they continued to pile up CMOs. By 1994, CMOs comprised 68 percent of CapCorp's investments. NCUA examiners, none the less, gave the corporate a CAMEL 1 rating with highest marks except in the area of management.

The corporate was switching from fixed-rate CMOs to indexed-rate ones which were supposed to help insulate against changes in interest rates. But about 45 percent of the CMOs were COFI-indexed, an index that tended to lag behind interest rate fluctuations.[274]

This investment structure was tottering as the Federal Reserve raised interest rates in an improving economy and even the indexed CMOs could not keep up with the rise in interest rates. The value of the more vulnerable CMOs was falling. NCUA examiners returned in November, 1994, and this time gave CapCorp a CAMEL 4 and ordered it to sell two CMOs that failed its stress test.

The forced sale resulted in a loss of $1.4 million. With the economy picking up steam, CapCorp's members had already been withdrawing funds from the corporate to meet increased loan demand. Hearing of NCUA's action, member credit unions, mostly the larger ones, began withdrawing deposits totaling half a billion dollars, a third of the corporate's assets. To meet the demand, CapCorp began borrowing against its CMOs but ran into NCUA's borrowing limits.

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[274] The rates on many adjustable rate mortgages vary according to changes in the Cost of Funds Index (COFI) of the 11th District of the San Francisco Federal Home Loan Bank District. The index is based upon the cost of funds to S&Ls in the district.

To halt the run, in December, 1994, at the instruction of NCUA, CapCorp's board, for the first time in corporate history, voted a 60-day freeze on withdrawals. In the interim, NCUA made credit available to CapCorp members through the Central Liquidity Facility.

With NCUA oversight, CapCorp began merger talks with WesCorp, but the parties could not agree on a merger formula. As the end of the 60-day freeze on withdrawals approached, the NCUA board on January 31, 1995, voted 2-1 to place the corporate into conservatorship. As was becoming common on important issues, board member Swan cast the dissenting vote.

To meet the funding needs of CapCorp's members, NCUA arranged a line of credit for them at U.S. Central, backed by the federal share insurance fund.

NCUA began selling off CapCorp's investments gradually, with an eventual loss of some $60 million. The corporate's primary capital absorbed the first $37 million of the loss. But the rest came out of Tier 2 capital, the membership shares CapCorp called Preferred Shares, that were held by member credit unions—which had always been at risk in such an eventuality.

However, no credit union's financial stability was endangered, and there was no loss to the National Credit Union Share Insurance Fund. CapCorp's membership and operations eventually were taken over by Mid-Atlantic Corporate Credit Union, which paid $600,000 to NCUA for the privilege.

Congress, as it had in the case of Banesto, reacted with considerable heat. The House and Senate banking committees held hearings on what Senate Banking Committee Chairman Alfonse D'Amato called "the largest failure by a credit union in American history."

The hearings put NCUA Chairman D'Amours in the hot seat. He conceded to the Senate committee that "CapCorp's problems might have been avoided had NCUA had an earlier

and better handle on corporate credit unions and their investments."

However, "it was CapCorp's board of directors that were primarily responsible for the operations of the corporate. The board failed to challenge the investment decisions that were made by senior management. They allowed the mission of CapCorp to become one of a high-yielding investment center rather than the safe and sound liquidity facility it was intended to be," D'Amours said.

Ironically, some of the credit unions like Navy Federal and Pentagon that strongly objected to CUNA's suit against NCUA found themselves among 94 members of the National Association of Federal Credit Unions (NAFCU) suing NCUA in November, 1996, arguing that NCUA had acted too hastily in forcing CapCorp to sell its underwater securities and taking it into conservatorship.

On April 16, 1997, the United States District Court for the Western District of Virginia dismissed the suit on procedural grounds, and an appeal also failed. However, some of the issues raised in the suit, especially how NCUA should evaluate troubled instruments like CMOs held by corporates, would surface again years later in the Great Recession of late 2007-2010.

Chapter 46

Dissension on the NCUA Board

The pressures of the corporate situation put a spotlight on the NCUA board's operations. Board member Robert Swan found himself in the minority both on the corporate interlocks issue and the seizure of CapCorp. In a speech to the Virginia league in March, 1995 he characterized the seizure of CapCorp as an "assassination."[275]

In response, D'Amours through his executive director Karl Hoyle asked NCUA regional directors to monitor Swan's public

[275] "The Gloves Are Off at Credit Union Agency, with Chairman, Director Openly at Odds," American Banker, May 1, 1995, p. 1.

speeches and report back to the office of the chairman. Swan subsequently apologized to the board for his Virginia remarks, and the monitoring was halted.[276]

The monitoring incident was one of several attempts to exert authority by D'Amours and Hoyle that alienated both board member Shirlee Bowné and Swan.

It was a different atmosphere at the NCUA from the Jepsen years, when, according to Bowné, the board had operated on a collegial basis and there had been an informal free interchange of information between board members and the senior staff. Under D'Amours and Hoyle, communications were more restricted. For example, the chairman and executive director insisted that information about CapCorp be channeled through their hands rather than going to other board members directly. D'Amours later sought to justify this by saying he suspected Swan was leaking information about CapCorp to credit unions that might sue NCUA.

D'Amours was in charge of meeting agendas, and Swan and Bowné found it difficult to get their items placed on the agenda in a timely fashion. Swan's and Bowné's complaints led to a hearing and a scolding of D'Amours by the House Banking Committee's subcommittee on general oversight and investigations—a committee on which he once served..

The subcommittee also asked the General Accounting Office to investigate. The GAO concluded that D'Amours and Hoyle had done nothing illegal. "However, because of the apparent distrust and animosity that existed among Board members and in some cases extended to certain senior staff, the influence and effectiveness of the other Board members were almost certainly diminished."[277]

Robert Swan's term on the NCUA board ended in August, 1995, but the law establishing the three-person board in 1978

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[276] Letter responding to a request by the House Banking Committee's Subcommittee on General Oversight and Investigations for an investigation of complaints from Swan and Bowné concerning D'Amours' management of agency, Government Accounting Office, April 8, 1997.

[277] Ibid.

stated that any member of the board “may continue to serve as such after the expiration of his term of office until his successor has been appointed and has qualified." Swan remained in his post.

In November, 1995, President Clinton chose Yolanda Wheat, a banking attorney, for the Swan seat. She and her husband, a former Democratic member of Congress from Missouri, had close ties to the Clinton Administration. But her approval by the Senate was delayed.

In January, 1996, Clinton asked Swan to step down, presumably so the president could make a recess appointment of Wheat to the board while Congress was away on its January break.[278] But Swan refused, questioning the legality of replacing him with a recess appointment. He said staying on was a matter of conscience. "I had made a commitment to literally thousands of credit union people that I would stay until replaced because there are a lot of things on the table," he told the American Banker. "People are hopeful that someone familiar with the past history would be there."[279]

When Congress went home for its 1996 spring break, Clinton made a recess appointment, and in an April 8 letter, his assistant Robert Nash informed Swan that the president was removing him from office effective the next day. NCUA Executive Director Hoyle told Swan to vacate his office, and he did so. Wheat took her board seat April 15, 1996, in time to vote with D’Amours to approve the amended corporate rules. This time it was Bowné who cast a dissenting vote.

Swan sued to regain his seat on the board, claiming the president had acted illegally. His suit was supported by a number of credit unions that contributed to a blind trust he had set up to help pay his legal expenses, called the “Trust to

[278] If the Senate is not meeting, the Constitution gives the president authority to put an official into a post without Senate confirmation, though the appointment eventually does need Senate approval.

[279] “NCUA Director Whose Term Is Up Refuses to Make Way for Clinton Pick,” American Banker, January 24, 1996, p. 1.

Preserve an Independent NCUA."[280] Some said it was unethical for a former regulator to solicit funds from institutions he might be in a position to regulate if his suit succeeded. However, the Office of Government Ethics said that the trust fund was not illegal because Swan was no longer a regulator and the fund was established after he left his post. And Swan said because it was a blind trust, he did not know who contributed to it.

The courts eventually upheld the president's appointment of Wheat, and Swan returned to private life as a credit union consultant.

In August, 1997, a new NCUA brouhaha erupted when the federal Office of Personnel Management (OPM) took away NCUA's authority to hire, though it was later restored. As a result of an audit at NCUA, the OPM charged that the agency had seriously violated federal merit rules in its efforts to hire more minority examiners. However, only a few minorities were among those hired during the audited period.

Acting OPM Director Janice R. LaChance, at a September 30, 1997, hearing of the House Banking Committee's Subcommittee on General Oversight and Investigations, said the violations were the worst the OPM had seen in many years.

Illegal hiring shortcuts apparently had been going on for years before the D'Amours-Hoyle administration. It isn't clear just how much Executive Director Hoyle knew of the details of the selection process. But he was in charge of increasing diversity at the NCUA and insisted that he have final approval over all job hires. He asked regional directors to supply race, ethnic, and disability data on applicants, although he denied using those factors in making hiring decisions.

NCUA board member Bowné was succeeded by Dennis Dollar, who had been a credit union CEO in Mississippi. The NCUA board held Hoyle responsible for the problems in the audited period and ultimately fired him, although D'Amours voted against it. Hoyle sued over the firing, saying only the

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[280] "Credit Unions Help Finance a Bid by a Dismissed Federal Regulator," New York Times, July 20, 1996.

chairman could legally terminate him. The courts upheld the firing.

Chapter 47

CUNA Overhauls Itself—The Renewal Project

The challenges in the Corporate Network were not the only stresses in what former CUNA president Jim Williams had dubbed the Credit Union System. As we have seen, the dispute over CUNA's attempt to compromise on the one percent insurance deposit exposed fissures in the CUNA-league structure, as credit unions, especially the fast-growing larger credit unions, demanded a greater direct voice in CUNA affairs.

The steps CUNA President Swoboda had so far taken to give credit unions more direct access to the national level were modest in comparison with what now took place—the Renewal Project.

"As the credit union movement has grown more diverse in size, membership, and outlook, and as larger credit unions become more self-sufficient, debate grows about the utility of movement institutions," Swoboda reported to the CUNA Annual General Meeting in late October, 1995.

"As credit unions prepare to enter the 21st Century, the time has come to look at the movement's organizational structure with fresh eyes and to ask if it is the best structure to meet the future needs of credit unions and their members.

"That is why, after consultations with CUNA Mutual, the Credit Union Roundtable, ACULE, the CUNA Board and other segments of the movement, CUNA has launched the Renewal Project."

The Renewal Project grew out of discussions between CUNA Mutual's new president, Mike Kitchen, and Swoboda—although Swoboda gives credit for the initial idea to Kitchen. Their discussions led to what amounted to a movement-wide "town meeting." This was an ambitious effort to gather input from credit unions and leagues on what should be the future shape of the Credit Union System.

The project was guided by a steering committee of 26 people, chosen to represent all segments of the movement. Robert Bream, president and CEO of United Airlines Credit Union chaired the committee in its later stages.

The initial, information-gathering stage included three surveys and a series of focus groups. The final survey was sent to all 11,840 credit unions in the nation, including those not affiliated with CUNA through membership in their leagues. More than 4,200 credit unions of all sizes responded.

The focus groups and surveys showed that credit unions:

● wanted more direct input into CUNA policy and lobbying positions, and

● believed that CUNA's primary mission should be traditional trade association services like lobbying, training, public relations, and economics and research.

In connection with the second point, larger credit unions tended to favor a more purely trade association role for CUNA with less attention to providing products and services. Smaller credit unions pointed out that many services available to larger credit unions in the commercial market were not available at a reasonable price to small credit unions. Because they had less negotiating power with vendors than the larger credit unions, they still relied a great deal on their leagues and CUNA for those products and services.

In the summer of 1996, the CUNA Board approved the findings of the Renewal steering committee and set forth 15 recommendations for change. Chief among them were these:

● League-affiliated credit unions would be members of CUNA in addition to being members of their league.

● Credit unions would directly elect a 75 percent majority of the CUNA Board.

● Credit unions could provide direct input to CUNA and their league on issues like governmental affairs.

● Leagues would still be members of CUNA, and league presidents would be elected to 25 percent of the seats on the CUNA Board.

These recommendations were incorporated into bylaw changes that were approved at CUNA's Annual General Meeting in September, 1996. The resulting CUNA-league structure has stood relatively unchanged since then.

By the time the Renewal Process ended, CUNA had a new president.

The CUNA Board asked Swoboda to resign at the October Annual General Meeting, in 1995. The immediate cause was a large cost-overrun in CUNA Service Group's project to switch to a new card processing software system. Among other things, CUNA Service Group's Card Services had to cancel a contract with ALLTEL for operating the new software, at a penalty of some $8.8 million.

Swoboda stepped down at the end of 1995 and went on to a successful career in international credit union consulting, including three years as chair of the Management Committee of the Association of British Credit Unions.

Pete Crear, CUNA's chief staff officer, served as acting president until a new one could be chosen. In line with credit unions' desire for a focus on lobbying, the Board eventually chose Dan Mica, a former congressman who had become a major insurance lobbyist. Mica was the first CUNA president hired from outside the movement.

CUNA's headquarters had been in Madison, Wisconsin, since its formation in 1934, with an office in Washington, D.C. "My initial reaction (to an approach by a search firm) was my home had always been in Florida or Washington, and this initial job description had the residence of this position in Madison," Mica remembered. "I said no."

But the more he looked at credit unions, the more they "sounded very exciting, very challenging." Eventually, the gap was bridged, with Mica agreeing to spend several days a month in Madison for at least two years, while spending most of his

time in CUNA's Washington office and maintaining his D.C. residence. Mica shifted the association's top staff to the nation's capital, thus making Washington the de facto headquarters of CUNA. CUNA/CUNA Service Group operational staff remained in Madison.

The new president had three serious challenges on his plate: resolving CSG's Card Services situation by selling off the business to another vendor, dealing with hostilities between the credit union movement and its regulators, especially NCUA, and a banker court challenge to the more liberal field of membership regulations promulgated in the early 1980s.

A deal to sell Card Services was reached with Equifax Payment Service, a leading card processor for banks and credit unions, in September, 1996, and the sale took place December 3.

The tensions with NCUA would take much more time to resolve; in fact, relations improved only when D'Amours' time at NCUA ended in late 2000. Mica, who had served in Congress with D'Amours, felt at the beginning he could "reset" CUNA's relations with the chairman. However, he quickly found this was difficult, if not impossible. As Mica put it to the author, it seemed to him that every time CUNA took two steps forward, D'Amours would take three steps back. And in the end, frankly, it was nasty, Mica said. "It was ugly."[281]

Chapter 48

Movement Rallies in Oklahoma City Bombing

On April 19, 1995, Patti Hall left her desk at the credit union on the third floor of the Murrah Federal Building in Oklahoma City to go to a supply closet. Moments later, she was lying amid tons of rubble with 40 of her bones broken. A fellow employee who had momentarily sat down at Hall's desk perished.

The Federal Building had been the target of what at that

[281] Mica, Dan, Interview, September 13, 2004, CUNA Information Resource Center Archive.

time was the deadliest terror attack in the nation's history, a truck bomb set off by Timothy McVeigh, an American with a grudge against the government. The front half of the building caved in.

After Hall was dug out of the ruins and was stretched out on the sidewalk, her boss, Florence Rodgers, found her and said, "Patti, honey, how are you doing, honey?" and she weakly replied, "I hurt real, real bad, Florence." [282] Hall would be in a coma for five weeks. In eighteen surgeries, doctors pinned her bones together with more than two dozen metal pins and plates. She would not be able to work again.

Rodger's own escape was just as arbitrary. Known affectionately as "Mother Goose" to her employees, the CEO of Federal Employees Credit Union (FECU), was in conference with most of her senior staff in her office when the building dissolved in front of her and her managers disappeared. She was thrown against the wall. She crawled through a window and escaped from the third floor down a stairwell. Her injuries were minor enough so that she was able to lead the effort to bring her credit union back into operation.

The $75 million asset credit union served more than 15,000 federal employees scattered around the world. Its records and equipment were destroyed in the blast. Eighteen of its 33 employees were dead, five were hospitalized, and many of the rest were too traumatized to work.

But in addition to Rodgers, survivors included two key managers who were out of town on that day, Raymond Stroud, vice president and controller, and Brad Grant, the credit union's data processing specialist. As the credit union movement rallied to help, the three of them put the credit union's disaster plan into effect. The blast had occurred on a Wednesday morning. By Friday, Federal Employees Credit Union was back in operation.

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[282] "Survivors struggle in a different world," Scripps-Howard News Service, SouthCoastToday, New Bedford, Massachusetts, February 22, 1997.

View of bombed Murrah Federal Building. (FBI Photo)

Tinker Federal Credit Union, serving the Air Force base of the same name, offered the use of its nearby new corporate operations center and employees to help. FECU had backup computer records stored off-site, and these were immediately shipped to a vendor's "hot site" in Pennsylvania to begin the recovery.

The Oklahoma League fielded phone calls from across the nation and provided what information was trickling in. League President Bob Bianchini drove to Oklahoma City to get a first-hand view of the recovery effort. He recalled the scene at Tinker:

"In that room were the CEOs and staff members of every Oklahoma City credit union and credit union leaders from around our state. They were behind the teller line . . . answering telephones . . . working with members . . . and in some cases just putting their arms around members who were seeking comfort, or information about Federal Employee staff they did not see when they walked in.

"Many credit unions and leagues from around the country

called to offer assistance. Some of the items offered were things we hadn't thought about—extra calculators, teddy bears for the kids, along with countless other wonderful expressions of concern and support."[283]

In the weeks and months following the tragedy, Florence Rodgers proved to be a stalwart resource for her credit union and for the movement in general, making speeches about the event and the lessons she drew from it. Earnings from her speaking were given to the organization that created the national memorial to the 168 persons killed and the 500 wounded in the blast. She also took an active part in planning the memorial. She retired in 1997, and her vice president, Raymond Stroud, became CEO.

The credit union movement showed its support through not only volunteering immediate assistance but in raising $1.4 million through the Credit Union Foundation for the families of the FECU employees. [284]

The bombing alerted credit unions and other financial institutions of the need to have disaster plans and record preservation procedures in place. Unfortunately, not every credit union heeded the wake-up call.

Chapter 49

That Old Time Philosophy

The movement's outpouring of aid in response to the Oklahoma City bombing was an example of credit union philosophy in action. "Philosophy" is a catch-all phrase used by credit unionists to describe their idea of how the movement should function.

As stated in Chapter 1, the U.S. credit union movement began in the early 20th Century as a reform movement to bring lower-cost financial services to people of small means, close to a subsistence income, who were largely neglected by the

[283] "Oklahoma Credit Union League official offers perspective of industry's family," Oklahoma City Journal Record, April 18, 2000.

[284] Now the National Credit Union Foundation.

banks. At that time, people of small means included most Americans—telephone operators, railroad workers, government employees, etc. and their families. Banks focused on commercial loans and serving the well-to-do, whose creditworthiness they could rely on.

Working-class Americans were prey to loan sharks charging exorbitant rates of interest for small loans. The battle cry of the credit union pioneers was fighting usury—excessive interest rates on loans. They also often saw credit unions and other cooperatives in broader terms, as a way of ameliorating the unbridled capitalism of the day and extending the benefits of economic growth to the "common man."

The goal of serving "people of small means" was included in the 1934 Federal Credit Union Act. The current version of the law uses the term "modest means." But credit union "philosophy," as it came to be called, encompassed much more than serving people of small or modest means. It included the idea of economic democracy—people joining together to take control of their own financial destinies. It included what credit union pioneer Roy Bergengren called demonstrating in a practical way, "the brotherhood of man." It included cooperation among credit unions and with other cooperatives.

In 1937, Elmer Bloom, a Missouri credit union volunteer, encapsulated the mission of credit unions in the slogan "Not for profit, not for charity, but for service." Another common slogan also came into use: "People helping people."

Almost from the beginning, as the credit union movement grew, there were some who felt that credit unions were moving away from their roots. For example, as credit unions began hiring paid managers and other specialists, instead of relying mostly on volunteers, Roy Bergengren warned against placing too much power in the hands of professionals. Such tensions have continued during the period covered by this book, popping up in many different ways. (The broader cooperative movement has felt many of the same tensions as it has adapted itself to the modern economy.)

As one former credit union board member put it in a letter

to the *Credit Union Times*:

"It appears to me that as credit unions grow, mature and evolve, they devalue traditional credit union philosophy across the board. While credit unions may still be a member's best overall choice of financial institutions, they are not the shining light they once were."[285]

The same point was made more sharply by John Isbister, a student of community development credit unions. He argued that "The transformation of the credit union ethos is not complete . . . But for the most part credit unions in the United States are a standard, if relatively small component of the nation's financial system, catering to the savings and borrowing needs of middle-class employees."[286]

Although the term "philosophy" has been bandied about freely, people use it in many different ways. To some, it represents "the way we used to do things." To others, it is simply "good member service."

When Ralph Swoboda assumed the CUNA presidency in 1986, he was among those who felt that in the new competitive credit union world, philosophy was being neglected.

He did not believe that there was any one best way for credit unions to serve their members, but he did think that CUNA needed to promote a vision "that relates to the fundamental purposes of credit unions, why they exist. I'm talking about the philosophy of cooperation, economic democracy, people banding together to fulfill their mutually determined economic destinies."[287]

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[285] Livingstone, John, Member, Telcom Credit Union, Southfield, Michigan, Credit Union Times, October 20, 2000.

[286] Isbister, John, *Thin Cats: The Community Development Credit Union Movement in the United States,* 1994, Center for Cooperatives, University of California.

[287] "CUNA'S New CEO Seeks Unity," Credit Union Magazine, April, 1987, pp. 10-11. The author of this book joined CUNA's public relations staff as speechwriter shortly before Jim Williams resigned as president of the association. While traditionally the CUNA president addressed CUNA operations and practical credit union concerns in his speeches and the chairman talked philosophy, this order was reversed under Swoboda. The

Credit union philosophy was especially significant in the stormy financial and political climate of the S&L imbroglio, Swoboda felt.

First, in the wheeling-dealing, profits-first, ethics-second climate of the time, credit unions could veer off course in search of growth and higher executive compensation.

"You see more and more people coming into the credit union movement viewing it as a way to achieve personal advantage and personal advancement, as opposed to serving credit union members. One word for it is greed," Swoboda said.[288]

Second, the cooperative idea, the not-for-profit-but-for-people philosophy, was the movement's prime defense against bank efforts to persuade Congress to rein in credit unions and eliminate their historic exemption from corporate income taxes.

"The only way credit unions are going to survive," Swoboda emphasized, "is by remaining true to their ideals. That's the niche we fill as a non-profit alternative for consumers, an alternative that helps keep the rest of the financial movement honest."[289]

CUNA tried to define credit union philosophy more precisely. Its "Seven Cooperative Principles for Credit Unions" drew on principles arrived at by the International Cooperative Alliance.[290]

The cooperative principles included democratic control, one member-one vote, non-discrimination, education of members, cooperation among cooperatives, and community service.

To focus attention on the importance of credit union philosophy, CUNA in 1987 established the Dora Maxwell Social

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chairmen tended to talk about topics like the competition, while Swoboda stressed the need to stick to credit union ideals.

288 Ibid.

289 Ibid.

290 The International Cooperative Alliance (ICA) was founded in 1895. In 1937, it agreed on a list of seven cooperative principles. These became the basis of today's ICA International Cooperative Principles.

Responsibility Recognition Award to honor credit unions for their good works in their communities.

Three years later, it established the Louise Herring Award for philosophy in everyday operations. Both were named after women pioneers of the credit union movement.

CUNA in 1994 developed a checklist that credit unions could use to evaluate their philosophical soundness.

CUNA also maintained support of the Credit Union Development Education (CUDE) Program, which was originally started in 1982 by the World Council of Credit Unions (WOCCU) with funding from the U.S. Agency for International Development.

The CUDE program trained hundreds of credit unionists about how credit unions were addressing world poverty. Many who went through the week-long training said that it changed their lives.

When federal funding dried up in the mid-1980s, CUNA assumed responsibility for supporting the CUDE program, and CUDE's focus expanded to include community development in the United States and promoting credit union philosophy.

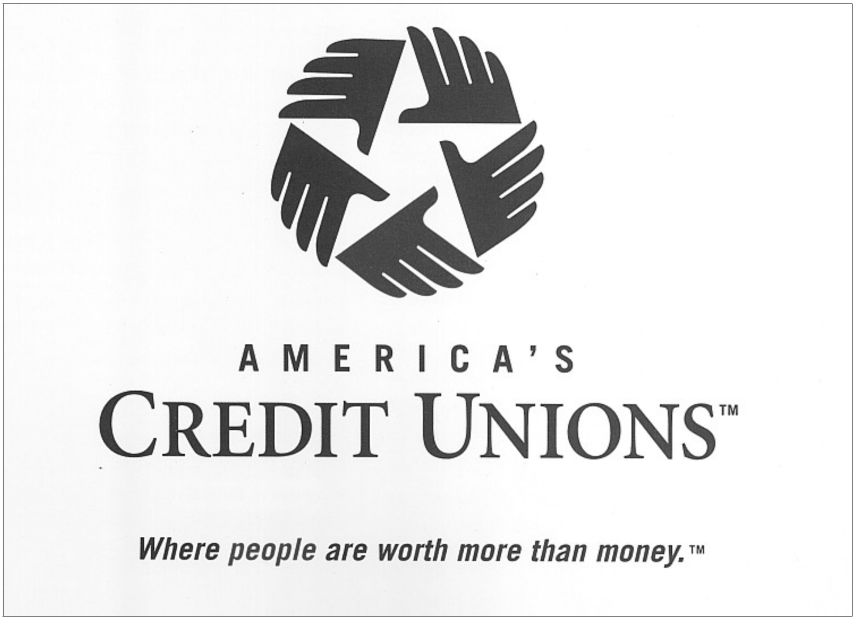
As the number of CUDE graduates rose, they became influential in many areas of the movement, from credit union operations to the regulatory agencies.

In 1995, CUNA launched a series of public service television spots, coordinated by the National Credit Union Foundation, emphasizing the importance of values like fairness and serving others, thereby suggesting to the public (and credit union people) that those values were important to credit unions.

Dan Mica, when he became president of CUNA in 1996, continued to emphasize the importance of philosophy in credit union affairs, both because he valued it and because he was aware of how vital it was in maintaining the support of Congress.

In 1998, CUNA followed up its philosophy checklist with a template “Statement of Commitment to Members” that it urged

all credit unions to use to create their own statements under a program known as "Project Differentiation." Hundreds of credit unions and leagues created such statements proclaiming their devotion to cooperative principles.



The Values Campaign evolved in 1999 into the National Brand Campaign, which sought to provide a common image for credit unions above and beyond their own marketing efforts. (CUNA/Credit Union Magazine Graphic)

Chapter 50

Issues of Governance

The next few chapters will look at some specific areas of philosophical controversy.

By 1995, the average U.S. credit union had 5,667 members. Many credit unions were expanding through select employee groups (SEGs) and mergers, or changing to community charters. Multiple-group credit unions now served the majority of the nation's credit union members.

This growth in size had ramification for governance. The procedures for elections to the credit union's board are contained in its bylaws. Obviously, the idea of “one member-one vote” has a different meaning in a credit union with a few hundred members and one with tens or hundreds of thousands of members.

Where once many or most of the members could take part in the annual meeting and were personally acquainted with board members, now the average credit union found it could not attract more than a small minority of its members to the annual meeting, and most members were not well acquainted with the men and women who represented them on the board. In short, on the spectrum of democracy, the greater member involvement in the older “populist” credit union was giving way to representational democracy in which the membership had little active role in the credit union apart from using its services.

Voting for the board still generally took place at the annual meeting, but many credit unions supplemented this with mail balloting and voting at teller windows to try to ensure member participation. Nonetheless, many members did not vote and often were not interested in serving on the board.

Many credit unions were establishing nominating committees to find board candidates, but at the same time they often were raising the bar to serving. Roy Bergengren had faith in the ability of the average working person to master the job of governing a credit union, and some credit unionists still shared that faith. But increasingly, credit unions screened potential volunteers to find certain qualifications. They looked for experience in financial matters, marketing, and other areas of expertise.

Many incumbent board members had no opposition when their terms expired and continued in service, sometimes for decades. With immigration and demographic trends making the population more diverse, credit union boards failed to keep pace, a condition still prevalent as of this writing. Research has shown that in both for profit businesses and nonprofit

organizations, boards made up of directors with diverse views and backgrounds tend to make better decisions. But a Filene Institute white paper has found that "the average credit union board remains largely older, male, and white." The white paper notes that the typical board member "has served on his credit union's board for well over a decade, and has a better than average chance of serving on the board for many years to come."[291]

Obviously, long experience on a board has value, but the flip side is that credit union boards are not generally representative of their membership in terms of age, gender, and ethnicity. There are a number of efforts to remedy this situation, including term limits for directors and outreach programs, but credit unions "have been slow to adopt them," the white paper reports.

In addition, as credit unions have grown, it has become more difficult to challenge board incumbents if a member or group of members is dissatisfied with the direction of the credit union. When a credit union had only a few hundred members, a challenger could reach out to the members with phone calls or visits on the shop floor. When a credit union has 30,000 members, running a campaign for board election becomes much more difficult and expensive.

This is especially so if the incumbent board puts roadblocks in the way, which boards have been known to do. This constitutes a kind of "moral hazard" that boards need to steer clear of.

However, this does not mean that credit union boards are undemocratic. For instance, credit union boards do about as well in the area of diversity as the boards of the Standard and Poors 500.[292] Credit union directors generally understand they represent the interests of the members. Credit union management and boards also understand that members can

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[291] Hofheimer, George A, Chief Research Officer, Filene Research Institute, "Effective Credit Union Board Succession Planning: A White Paper Commissioned by CUNA's Community Credit Union Committee," pp. 3-12.
[292] Ibid.

"vote with their feet" and that if the credit union is to survive in today's highly competitive marketplace, it must satisfy their needs. Therefore, they use a variety of ways of communicating with members and determining their opinions, including newsletters, surveys, websites, and nowdays, Facebook pages as well.

In researching this book, the author queried a number of his fellow Credit Union Development Educators about this issue of board qualifications and elections:

CEO of a small community credit union in Canada, who has also worked in big and small credit unions in the U.S.: *Allowing Director nominations from the floor at AGMs (annual general meetings) is no longer encouraged here in Canada, because history has shown this resulted in poorly educated, self interested people being elected. This still happens now in credit unions in developing countries, with disastrous results.*

We have a nominating committee chosen from members of the Board who determine the skill sets needed, which are advertised to the membership. Interested members must submit an application, which includes a financial statement, and a criminal background check. They must state their qualifications and then the application is reviewed by the committee. The committee will let members know if the applicant meets the criteria and they will be added to the slate of nominees. If fair is allowing all members the opportunity to apply, then I believe it is.[293]

Official of a very large credit union: *As we sit here opening THOUSANDS of envelopes from our members who have voted on a proposed merger, I can definitively assert that we, indeed, remain a democratic institution with an engaged membership.*

I have received numerous questions about the proposed merger from truly interested members. I find myself thanking all the members who contact us, whether they are in favor of the merger or not, because it's refreshing to know that we have

[293] E-mail to author, July 19, 2012.

thousands of members who have taken the time to vote and some who have taken the time to get more information and express their interest.

On a final note, I had a member call and ask "if I have $500,000 with the credit union, does that mean I get 500,000 votes?" With just SLIGHTLY excessive pride, I responded "No sir, (our credit union) is a truly democratic organization - one member, one vote[294].

Official at a credit union serving 1.7 million members through 244 branches: *We have a volunteer Advisory Board of 12 members attached to every branch. They meet quarterly to discuss local issues for that branch and for the local manager to address any concerns. In addition, the Board prepares a Quarterly Feedback question for the Advisory Boards to discuss topics of interest to the Board. For example "What, if any, additional services do you think we should offer for our laid off members?" or "What kind of products should we be developing for our retiring/baby boomer members?" Minutes from these meetings and answers to Feedback Questions are shared with the Board.*

In addition to the Annual Meeting where Board members interact with members (We have over 2,000 at the meeting - no gimmicks, no give-aways, etc. They come to be educated about their CU), the Board also holds one monthly meeting each year somewhere. . . in the state . . . with a "Meet and Greet" for the local area Advisory Board members so they can chat on a smaller group level (150-200). We also have monthly newsletters to members, a website, an annual member survey, etc.[295]

Credit union vice president, electronic delivery: *We have about 43,000 members and when they give us feedback, we listen. No question we are member centric and think about the collective in every decision we make. I worked for a bank prior to my credit union career and there is a very big difference. So yes, even though a lot has changed and credit unions are*

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[294] Ibid.

[295] Ibid

larger - members still have say on how the credit union is run. . . .Our board members are part of our community. The live and work in our area. Therefore, they live and work alongside with our membership. Most work for our core membership groups - military or education. The annual meeting is one way for members to communicate with our board. We also do member surveys and pass this information on to the board.

(The annual meeting is probably the least effective way of determining member opinion, because most members don't come.) We post all contact information on website and ask for feedback on how we are doing. We communicate with members via social media and they can ask any question or give feedback to us. More importantly, any senior manager will talk to a member at any time. I personally give my direct number to members so they can reach me if they have any feedback on any area that I am responsible for within the credit union.

As you can tell, from working on both sides (Banks and Credit Unions), I still believe in the difference in credit unions. Banks do fantastic things for their customers, but membership in a credit union is different. It is more personal. Individual opinions matter.[296]

Credit union learning and development specialist: *Just some thoughts from a Canadian credit union. We are a 36,000 member, $630 million, 200 staff member credit union located in Southwestern Ontario. We work very hard to ensure that our members stay as engaged in the democratic process as possible.*

A number of years ago we secured the domain name http://onememberonevote.com/ and we use this microsite to educate our members about the upcoming elections each year. We hold open meetings several times for anyone to come out and learn about the board's role and responsibilities, and what election to our board entails. Nominees have a message recorded that plays on the microsite and also loops on a television in all of our branches prior to the elections. This not only brings awareness about the elections and the AGM, but it

[296] Ibid.

ensures that all our members are making educated voting decisions.

Members are able to vote in branch prior to the AGM and our branches have daily and hourly internal contests to incent them to encourage as many members as possible to participate in the voting process. Our AGM is split over two days to encourage members in both of our geographic regions to attend (three hour travel distance between our regions). All in all, we are very true to the co-operative principles and our values of transparency, advocacy, collaboration, creativity, initiative and sharing.[297]

Chapter 51

Word Wars

Traditionally, regulators had not permitted overlaps in fields of membership—in other words, if you belonged to one credit union you could not join another. But in a trend started by the state regulators in Utah and picked up by other states and NCUA, these restrictions went by the board in the 1980s and 90s. As a result, credit unions increasingly had to compete with each other for members and member dollars as well as with banks and other financial providers. Would the tradition of "cooperation among cooperatives" go by the wayside?

California was one of the states where intramural competition was most intense. The aerospace and defense industries so important to the state were stagnant or being downsized. For example, Lockheed merged in 1994 with Martin-Marrieta and moved its headquarters to Maryland. That left Lockheed Federal Credit Union in Los Angeles with a stagnant membership base. but it was able to grow by adding SEGs unrelated to Lockheed. [298]

Dave Chatfield, former NCUA board member and president of the California League, used the term "coopetition" to

[297] E-mail to author, July 20, 2012.

[298] "Credit Unions May Be Forced to Severely Restrict Membership," Los Angeles Business Journal, February 17, 1997.

describe the new situation. Credit unions, he argued, could compete and cooperate on common goals at the same time.

As this example shows, the continuing evolution of the movement was reflected in terminology.

Credit unions, to some extent, had abandoned traditional credit union terms to adopt the language of other businesses. The volunteer board president was now "chairman of the board." The manager was now "president and CEO." The assistant manager often became a "COO."

"Member education," the traditional function of the credit union to educate members about the credit union and personal finances, became "marketing," which some complained shifted the focus to selling product. Within the marketing area, the post of "business development officer" was added to reach out to and persuade select employee groups to join the credit union.

Changes in terminology did not go unchallenged, exposing uneasiness over identity and purpose. Should the credit union movement be referred to as an "industry"? Should members be called "customers"? Should share drafts be called "checks"? Should electronic service to members be called "home banking"? Should "net income" be called "profit"? Each of these terms stirred controversy and letters to the editor of credit union publications.

Some credit unionists argued that it was wrong to call credit unions nonprofit, because in fact they made a profit if they were properly run; rather it should be said they were "not for profit." These disputes had political ramifications. If credit unions abandoned traditional terms, many argued, it would erode their distinctiveness and lend weight to bank arguments that they should be taxed and regulated like banks.

Chapter 52

Serving the Underserved

As part of their attempts to strengthen the philosophical underpinnings of the movement, CUNA and the leagues

undertook to find ways to better serve the so-called "underserved"—Americans who lacked access to, or chose not to use, banking services and relied on pawnshops, check cashing stores, and other high-interest lenders for their borrowing needs.

In 1991, U.S. credit union membership increased by just over one percent, lagging behind population growth. In response, CUNA the following year launched Operation Moonshot, a program to stimulate membership growth. Moonshot had considerable success, with membership growth rising an average of 2.8 percent annually over the four-year span of the program. This was more than double the rate of population growth.[299]

One aim of the program was to encourage credit unions to expand their fields of membership and practices to reach out to underserved areas and groups, such as blacks and Hispanics.[300] As part of this, the monthly CUNA press newsletter "News About Credit Unions" was sent out to a list of black publications and in a Spanish translation to the Hispanic press.[301]

The sector of the movement that focused most directly on the goal of reaching the underserved were the credit unions founded specifically to serve poorer neighborhood, the low-income or community development credit unions (CDCUs).

Their relationship to the mainstream movement was complex and sometimes strained. Mainline credit unions remembered the failure of many CDCUs during the 1960s, 70s and 80s. They often felt that the CDCUs were founded on the wrong premise. "Poverty makes a poor common bond" was the

[299] CUNA Credit Union Growth Task Force Report, September, 2008.

[300] One result of the steady expansion of credit union fields of membership since the early 1980s was that the pool of people who were eligible to join a credit was growing much faster than the number who actually joined. By the 1990s, credit unions were serving only 33 percent of their potential members. This percentage would decline even further as fields of membership continued to expand in the new millennium.

[301] This publication, incidentally, was written by the author and edited by Jerry Karbon of CUNA Public Relations.

mantra of the skeptics, who argued credit unions needed to serve a range of incomes to be economically viable.

The CDCUs, in turn, often perceived the mainline movement as indifferent, if not actively hostile, to them. While some took part in league and CUNA activities, many focused on their own organization, the National Federation of Community Development Credit Unions (NFCDCU).

To strengthen its clout in Washington, the Federation formed a "strategic alliance" with the Credit Union National Association. "CDCUs participated energetically in CUNA's Operation Grassroots, to preserve the tax exemption of credit unions, and the Federation played an increasingly visible role in CUNA's activities. CUNA substantially increased its support to the Federation, enabling it to expand its capacity and initiate new programs."[302] The alliance eventually evolved into a looser arrangement where the Credit Union Foundation helped to support the activities of the National Federation of Community Development Credit Unions.

Relations between the NFCDCU and the federal regulator also improved once Norman D'Amours became chairman in 1993. "By 1992 the number of low-income credit unions sank to an all-time low of 142," states the NFCDCU's web history. "Mergers and forced liquidations became ever more common, and no CDCUs were chartered in 1990, 1991, or 1992."[303]

D'Amours, the NFCDCU's web history continues, "was a strong advocate of expanding credit union service to low-income communities. Under his leadership, NCUA reversed the population decline of low-income credit unions; the number of credit unions designated as low-income by NCUA grew by hundreds, even though very few new credit unions actually were chartered.[304] At the same time, D'Amours vigorously

[302] http://www.cdcu.coop/i4a/pages/index.cfm?pageid=472.

[303] Ibid.

[304] By 2007, the number of credit unions designated as "low-income" had risen to more than 1,000.

pressed the overall credit union movement to expand its service to low-income communities."[305]

Among other things, NCUA permitted CDCUs to enlarge their fields of membership to include more affluent areas of the community and also liberalized the restrictions on non-member deposits in CDCUs.[306]

The other side of the coin was encouraging mainline credit unions to extend service to poorer areas. In 1994, the NCUA Board under Chairman D'Amours approved Interpretive Ruling and Policy Statement, (IRPS) 94-1, which allowed federal credit unions to include low-income communities and associational groups within their fields of membership. Over the next several years, 73 credit unions expanded to serve low-income groups with a potential membership of 1.4 million.

One philosophical dispute that arose in the mid-1990s concerned "risk-based lending."

More and more credit unions were adopting a policy of charging different interest rates on similar loans depending on the credit-worthiness of the borrower.

This enabled them to give their most credit-worthy members a reward and lure them away from for-profit lenders. It also made it financially possible to lend to so-called non-prime borrowers who otherwise would have to turn to predatory lenders. And by increasing loans, it improved the bottom line of the credit union.

A number of credit unionists, however, argued that risk-based lending violated credit union philosophy because it treated members differently.

Risk-based lending was not without its own risks. While a credit union might earn more from a higher-priced loan to a sub-prime borrower, such loans required greater monitoring. "(We) work twice as hard on those loans," noted Joseph Prokop, chief executive of Taconic Educational and

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[305] http://www.cdcu.coop/i4a/pages/index.cfm?pageid=472

[306] The reader will recall these restrictions were put in place as a result of the fraud at Franklin Community Federal Credit Union. See Page 163.

Governmental Federal Credit Union, a $52 million institution in Fishkill, N.Y. "You have to watch those loans like a hawk. If they go delinquent five days, you get on the phone."[307]

Members might not understand why they were charged different rates on the same type of loan. And a credit union unless it was careful could fall afoul of fair lending laws. For such reasons, federal examiners at first tended to discourage this type of loan pricing until the D'Amours administration began encouraging it as a way of reaching the underserved.

In a letter to credit unions in 1994, D'Amours said, "Credit unions should engage in risk-based lending, not as a means of re-pricing existing balance sheets, but as a tool to reach out to the underserved and take a risk that might otherwise be avoided."

The number of credit unions moving to risk-based lending increased rapidly in following years.

Banks had been lobbying for years for credit unions to be placed under the Community Reinvestment Act (CRA).[308] They had allies among some who wanted to see credit unions serving more low-income Americans. Among these was Representative Joseph Kennedy (D-Massachusetts). In a 1994 hearing by the House Banking Committee's subcommittee on consumer finance, chaired by Kennedy, he made the case for CRA.

"When Congress adopted the Community Reinvestment Act in 1977, it exempted credit unions. The reason was very simple: Credit unions were small institutions with a small amount of assets serving only a small number of consumers. That reason no longer exists in many cases.

"Today, there is nothing small about the credit union industry. It is increasingly dominated by large institutions possessing large amounts of assets and serving a huge number

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[307] "Emerging Trend Seen In Risk-Based Pricing To Drum Up Business," American Banker, Oct 2, 1995, p. 8.

[308] Bank resentment of the Community Reinvestment Act and its record-keeping requirements was peaking in the mid-1990s.

of customers . . . . That kind of permissive charter looks a lot like the charters of banks and thrifts. But there is one big difference: Federally chartered credit unions, unlike banks and thrifts, have absolutely no obligation to serve the credit needs of all of the people that they are chartered to serve. The credit unions claim that they don't need such an obligation because they are by definition in the business of community investment. That may be true of many, if not most, credit unions. But on the whole, it is rapidly becoming a myth."[309]

He pointed out that his state of Massachusetts had a CRA requirement for state-chartered credit unions, and that they did not find it unduly burdensome.

Among those testifying against CRA for credit unions was retired Vice Admiral Tom Hughes, CEO of Navy Federal Credit Union, speaking on behalf of the National Association of Federal Credit Unions (NAFCU).

"Mr. Chairman, every credit union takes very seriously its statutory mandate found in the Federal Credit Union Act to make more credit for provident purposes available to people of small means.

"The motto, 'not for profit, not for charity, but for service,' captures the essence of credit unionism. Credit unions' primary focus is on service, a characteristic distinguishing them from other financial institutions. There is no group of stockholders or outside third parties for whom profits must be generated. Thus, credit unions offer a sharp contrast to the profit-oriented institutions of the financial services industry.

"Our experience at Navy Federal Credit Union epitomizes the dedication of all credit unions in meeting the credit needs of all of their members. We are a large credit union with 1.4 million members . . . serving many, many, many low- and

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309 Kennedy, Joseph, "Community investment practices of credit unions: hearing before the Subcommittee on Consumer Credit and Insurance of the Committee on Banking, Finance, and Urban Affairs, House of Representatives, One Hundred Third Congress, second session, September 22, 1994."

moderate-income people throughout the world. I would like to think of us as the largest small credit union in the world.

"Let me share with you a few of our statistics: 680,000 members, or 52 percent of our entire membership, have less than $100 in their share savings account; 350,000 of these members have less than $10 in their share savings account. One-third of our consumer loans are for less than $2,500, which is the smallest loan some large banks will make, given processing costs. We have no low limit to how much you can borrow.

"It may be tempting to dismiss anecdotal evidence about one credit union, however, in order to assist the subcommittee, NAFCU has conducted a survey of its members. That survey, which is detailed in my written statement, clearly shows that credit unions have not lost their commitment to members of limited means.

"Mr. Chairman, there is absolutely no compelling reason to bring credit unions under CRA, We don't know the benefit that would be gained. Credit unions' cooperative form of ownership doesn't warrant it and credit unions' record of member service doesn't justify it.

"Credit unions are not a part of the problem. Credit unions are a part of the solution when it comes to CRA. Credit unions offer a number of specific services that are tailored toward meeting the special needs of low- and moderate-income members. These include offering their members financial counseling, special programs geared for first-time borrowers and special programs to ensure that minority borrowers receive equitable treatment.

Hughes listed a variety of programs at Navy Federal to meet its low- and medium-income members' credit needs. "In summary, Mr. Chairman, credit unions were formed primarily to serve the needs of their members wherever they may be located, not to meet the needs of a geographic area. Credit

unions were established to serve the underserved, and credit unions are still fulfilling that mission."[310]

The National Federation of Community Development Credit Unions also testified against CRA for credit unions. But the issue of CRA would not go away, and it would surface again in the struggle over field of membership legislation in the late 1990s.

Chapter 53

Bankers Challenge NCUA on Field of Membership

A good example of a credit union that had grown through the addition of select employee groups (SEGs) was AT&T Family Credit Union[311] in North Carolina.

The credit union was chartered in 1952 to serve shop workers of Western Electric and AT&T and their families in three communities. By the 1980s, North Carolina's economy was in flux, with textile mills losing business to overseas suppliers, anti-smoking advocates attacking the state's tobacco industry, and AT&T unbundling itself into separate "baby Bells."

To protect itself from disruption, the credit union in 1989 applied to NCUA for permission to begin adding select employee groups. Among those it added was a string of furniture companies in the Asheboro area. This aroused the attention of four area banks and the American Bankers Association (ABA).

At the North Carolina League's annual meeting in 1990, representatives of the American Bankers Association and the Independent Bankers Association of America (IBAA) announced their intention to challenge NCUA's liberalized field of

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[310] Hughes, Tom, Testimony, "Community investment practices of credit unions: hearing before the Subcommittee on Consumer Credit and Insurance of the Committee on Banking, Finance, and Urban Affairs, House of Representatives, One Hundred Third Congress, second session, September 22, 1994."

[311] AT&T Family changed its name to Truliant in 1999.

membership policies in court. AT&T Family learned in December that it was to be the test case, with the ABA and four banks being the plaintiffs.[312]

The core of the legal case involved the interpretation of the common bond provision of the 1934 Federal Credit Union Act. As we have seen, Section 109 of the Act provided that "Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district."

What did this provision actually mean? Regulators had originally given it a restrictive meaning and permitted a federally chartered credit union to serve only a single group. But as noted earlier in this work, the NCUA under Chairman Edgar Callahan broadened its interpretation to mean that a credit union could serve multiple groups, as long as each group had a well-defined common bond. The bankers argued that NCUA had exceeded its authority under the Act.

The potential consequences of the challenge for the movement and for working people were enormous. If the bankers were successful, it might mean that many credit unions would have to disgorge their select employee groups and shrink to their original size—or might have to go out of existence if their original sponsors were no longer around. Even if the courts grandfathered current SEGs, a major avenue of growth for the movement would be shut off.

There were also consequences for the average American. An increasing number of people worked for employers who were not large enough to sponsor a viable separate credit union for their workers. Sixty-two percent of employers had fewer than the 500 workers needed to sponsor a federal credit union. On average, these workers earned lower wages and received fewer benefits than workers at large firms. If the

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312 The federal case was not the only court case involving fields of membership. In 1993 and 1994, state banking associations launched legal attacks in seven states—Maine, Michigan, Montana, Nebraska, Tennessee, Texas, and Utah. CUNA provided financial, public relations, and legal assistance on both the federal and state level. The bankers generally failed in their state cases.

bankers succeeded, it meant millions of lower- and modest-income workers would be barred from accessing credit union services.[313]

Some federal credit unions might escape the full consequences of an adverse court decision by switching to community charters or to state charters, since the majority of states permitted credit unions to serve multiple groups.

In November 1997 CUNA and the National Association of Federal Credit Unions (NAFCU) conducted a survey of federal credit unions with multiple groups. The credit unions were asked if they would give serious consideration to converting to another type of credit union if the Supreme Court ruled in favor of the banks and credit unions could not obtain immediate legislative relief. About 40 percent of affected federal credit unions responded they would give serious consideration to conversion to a state charter. Among the larger of these credit unions, accounting for 45 percent of the members and 54 percent of the assets in all multiple group federal credit unions, over half would give serious consideration to conversion to a state charter.

However, these escape hatches would not be open to all. Some state credit union acts, as in Maryland, provided for a single common bond but had a "wild card" provision that ensured their credit unions could compete with federal charters in terms of services—and this meant that they could add select employee groups as long as the federal regulators allowed it, but not if the federal authorities provided only for single group membership.

CUNA, NAFCU, and AT&T Federal joined the case as "friends of the court," i.e., as parties with a legitimate interest in the outcome. As the case progressed, the movement was reassured by legal victories.

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[313] Woodbury, Stephen A. and David M. Smith, Michigan State University, and William A. Kelly, University of Wisconsin-Madison, "An Analysis of Public Policy on Credit Union Select Employee Groups," Filene Research Institution, 1997.

The U.S. District Court for the District of Columbia found that banks lacked legal standing to bring the case. The bankers appealed. The three judges of the U.S. District Court of Appeals reversed the lower court's ruling and sent the case back to the District Court for judgment on its merits. The lower court ruled that the 1934 Act was ambiguous in its definition of common bond and that NCUA had interpreted it in a reasonable fashion. Once again, the bankers appealed

On July 30, 1996, the U.S. District Court of Appeals for the DC District found that Congress intended the Federal Credit Union Act to restrict credit unions to serving only one common bond group. It sent the decision back to the lower court to issue an order providing relief to the plaintiffs—the bankers.

"U.S. Court's 'Common Bond' Ruling Could Break Up 2,000 Credit Unions" was the headline in the American Banker trade newspaper the day after the Appeals Court decision.[314] But the lower court's order in response to the ruling was not quite so drastic. It forbade NCUA to approve any more select employee groups and ordered federally chartered credit unions not to admit any new members from existing SEGs. However, the Appeals Court lifted the order on Christmas Eve, permitting credit unions to continue enlisting new members from current SEGs.

The decision directly impacted 3,603 federal credit unions serving SEGs. CUNA estimated that the injunction denied credit union membership to 4,400 consumers a day. In short, as CUNA President Dan Mica put it, "(Banks) have placed themselves squarely against the interests of consumers."

CUNA, NAFCU, and NCUA might be at loggerheads in a number of areas, but on this issue they were united. NCUA, CUNA, NAFCU, and AT&T Federal Credit Union agreed to appeal to the U.S. Supreme Court. And since the appeal might fail, they would begin seeking a remedy from Congress.

NCUA, NAFCU, and CUNA filed an appeal to the U.S. Supreme Court November 26, 1996. They contested the

[314] American Banker, August 1, 1996.

standing of banks to sue and the decision of the U.S. Circuit Court of Appeals.

On February 24, 1997, CUNA Governmental Affairs Conference attendees stood and applauded when it was announced that the U.S. Supreme Court had agreed to hear NCUA's and CUNA's appeal. But the push to advance "just in case" legislation in Congress continued.

On October 6, 1997, the Supreme Court began its new session with the AT&T Family Federal Credit Union case. Each side had submitted written arguments. Now each side had half an hour to make oral arguments – with judges interrupting to ask questions.

The U.S. Supreme Court accepted the movement's appeal on the banker challenge to NCUA's field of membership policy. (Bigstock Photo)

The new U.S. Solicitor General, Seth P. Waxman, argued the cause for NCUA. Arguing on behalf of AT&T Family and the credit union movement was John G. Roberts, later to become Supreme Court chief justice.

The Court seemed to be most interested in the issue of whether the bankers had standing to sue—perhaps because this was a broader question than the meaning of the 1934 statute.

The Court released its opinion on February 28, 1998, again during CUNA's Governmental Affairs Conference. The news was bleak. The court, in an opinion written by Justice Clarence Thomas, ruled 5-4 in favor of the banks.

All parties to the suit, including the bankers, asked the District Court not to act further on field of membership until Congress had an opportunity to deal with the issue.

Chapter 54

Campaign for Consumer Choice

A possible legislative solution was already taking shape. But it almost failed before it could get started. As the U.S. District Court of Appeals' decision was appealed to the Supreme Court, both CUNA and NAFCU separately announced their intentions to develop legislative campaigns to overturn any adverse decision. The California League also started laying plans for its own, separate campaign. Credit unions, including many of the nation's largest belonging to both associations, felt the divided effort threatened duplication and inefficiencies in responding to the threat and demanded a single unified campaign.

"The major players then had a meeting in Chicago to decide on one game plan," recalled Randy Smith, CEO of Randolph Brooks FCU, who co-chaired the campaign's steering committee with Kevin Foster-Keddie, CEO of Washington State Employees CU. "Mike Kitchen (CEO of CUNA Mutual) was a major behind-the-scenes player in getting a coordinated effort organized and funded,"[315]

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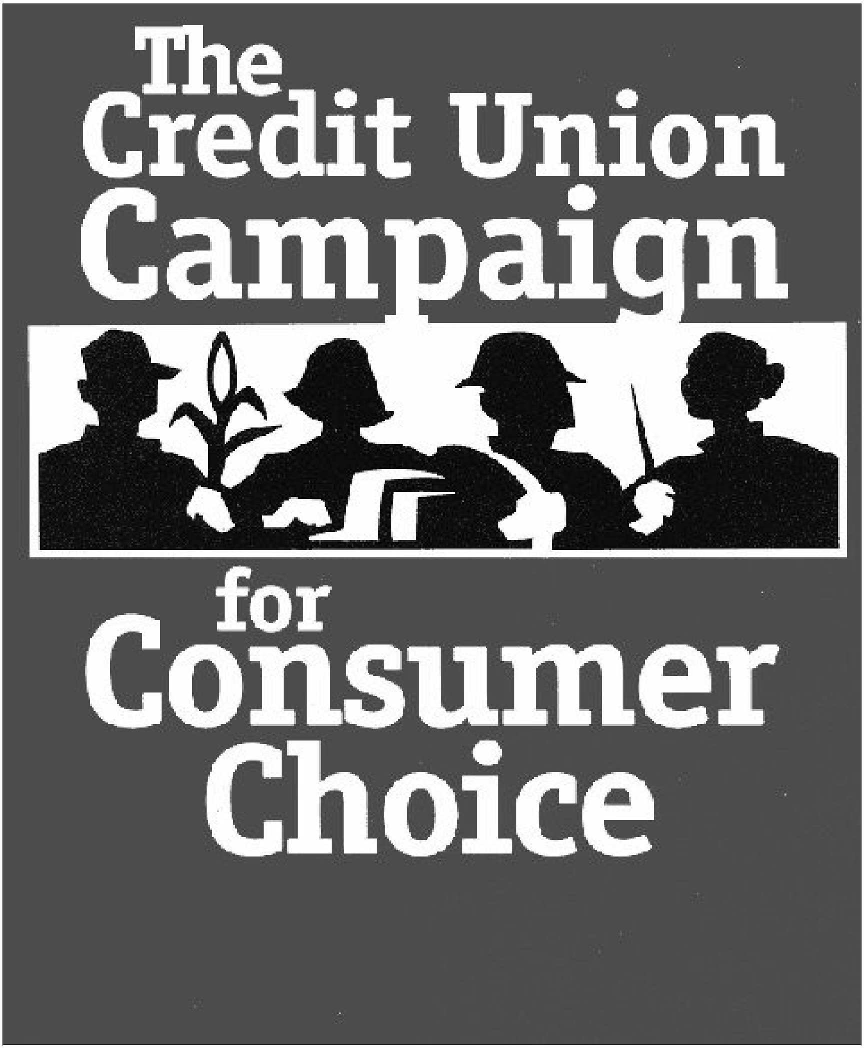
[315] "Rear View Mirror Reflections From The Steering Committee," The Credit Union Journal, August 4, 2003, p. 6.



The Campaign for Consumer Choice called for a broad credit union grassroots movement, with the aim of influencing Congress. (CUNA/Credit Union Magazine Graphic)

Under pressure from credit unions, the various campaigns were merged into a single effort: the Campaign for Consumer Choice.

Credit unions were not alone in closing ranks. Six banking trade associations had already formed a Credit Union Coordinating Committee to present a united front on credit union issues.[316]

To oversee the Consumer Choice Campaign, CUNA Mutual loaned its senior vice president of communications. Larry Blanchard had had extensive experience with CUNA, NAFCU, NCUA, and as a credit union newsletter publisher. Blanchard was an ideal choice, with contacts in all areas of the movement.

The Campaign for Consumer Choice began with a satellite broadcast to more than 175 sites around the country, reaching more than 4,000 credit union board members, managers, and members.

CUNA President Dan Mica and NAFCU's Ken Robinson took part in this largest interactive educational session in credit union history. Viewers were given tips on grassroots action on the local and national level to move public and congressional opinion toward the credit union cause.

As a result of this and later efforts by the Campaign, it's estimated that some three million people contacted their lawmakers, wrote letters to the editor, and/or petitioned Congress to remedy the situation. The great majority of the many newspapers editorializing on this issue came down on the credit union side, although some, like the New York Times, sided with the bankers.

Credit unions were not alone in this effort. The National Cooperative Business Association led an effort to get cooperative, consumer, farm, business, and labor groups to support legislation. By the end of 1997, nearly 100 organizations had joined the cause.

Meanwhile, the bankers were lobbying Congress heavily to slow or block any potential congressional action.

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[316] American Bankers Association, Independent Bankers Association of America, America's Community Bankers, the National Bankers Association, American League of Financial Institutions, and the Association of Military Bankers of America

Chapter 55

H.R. 1151

In the 1994 mid-term elections, a GOP surge led by Newt Gingrich (R-Georgia) erased the Democratic control of Congress and the banking committees. Although Clinton won his presidential reelection bid in 1996, the GOP retained control in Congress.

CUNA's chief lobbyist, Chuck Zuver, who had worked both sides of the aisle but whose political connections were formed when Democrats controlled Congress, told CUNA's new president, Dan Mica, he wanted to resign at the end of 1996 to give Mica a chance to put together his own lobbying team. He was succeeded by Carl Parks, who had close ties with the GOP, including serving as the congressional and public affairs liaison of the Republican National Committee. But it was obvious that Mica himself would play a leading lobbying role.

Meanwhile, the Campaign for Consumer Choice was getting under way as the credit union movement awaited the outcome of the legal battle over field of membership and sought to build support for a legislative remedy if the Supreme Court supported the bankers.

As already observed, lawmakers don't like to alienate any constituency. They prefer to have lobbying groups reach a consensus before approaching Congress. Credit unions were indicating clearly, however, that they wanted no compromise on this issue. It was bankers vs. credit unions, both powerful interest groups.

Many lawmakers hemmed and hawed as credit union lobbyists approached them. A major excuse for inaction was that the Supreme Court had not yet acted on the appeal.

Bankers recognized that Congress would probably pass some sort of remedial legislation, but they wanted to exact a price by limiting credit union powers as much as possible and imposing taxation and Community Reinvestment Act requirements.

Credit unions did not want to open up the 1934 Credit

Union Act to possible revisions to meet banker demands. They sought as narrow a fix as possible. Various members of Congress floated at least six bills. The credit union lobbyists discussed whether to go with a bill promoted by a single lawmaker or, as pushed by Mica, seek a bill with a number of co-signers from both parties that would have a better chance of attracting bipartisan support. The bill eventually backed by CUNA and NAFCU was H.R. 1151,which was both narrow and bipartisan.

Steve LaTourette, a Republican from Ohio, introduced the bill into the House on March 20, 1997. His fellow House Banking Committee member, Democrat Paul Kanjorski of Pennsylvania, signed on as the first co-sponsor. Sixteen other House members joined the effort as co-sponsors.

July, 1997, marked the first anniversary of the US Circuit Court of Appeal's decision overturning NCUA's liberalized field of membership policy.[317] Even though the U.S. Supreme Court had not yet weighed in on the issue, lobbying by credit unions had nudged 100 lawmakers in the House to sign on as co-sponsors of 1151.

After the Supreme Court made its decision, the House Banking Committee, chaired by Representative Jim Leach (R-Iowa), held a hearing on March 11, 1998 to discuss the decision and what to do with H.R. 1151.[318] By this time, H.R. 1151 had 185 co-sponsors in addition to Reps. LaTourette and Kanjorski. It would eventually have 207.H.R. 1151, at the time of the hearing, was short and sweet: *Section 109 of the Federal Credit Union Act (12 U.S.C. 1759) is amended by striking `Federal credit union membership shall be limited to groups having a common bond' and inserting `the membership of any Federal credit union shall be limited to 1 or more groups each of which have (within such group) a common bond.*

[317] As a result of Project Renewal, that summer also saw the first CUNA Board election in which credit unions as well as leagues voted—to fill 24 seats, including six reserved for the leagues. And Dan Mica completed his first year of the CUNA presidency.

[318] Hearing of House Committee on Banking and Financial Services, Wednesday, March 11, 1998.

105TH CONGRESS
1ST SESSION

H. R. 1151

To amend the Federal Credit Union Act to clarify existing law and ratify the longstanding policy of the National Credit Union Administration Board with regard to field of membership of Federal credit unions.

IN THE HOUSE OF REPRESENTATIVES

MARCH 20, 1997

Mr. LATOURETTE (for himself, Mr. KANJORSKI, Mr. SOLOMON, Mr. BROWN of California, Mr. LEWIS of California, Ms. KAPTUR, Mr. MCDADE, Mr. DINGELL, Mr. BURTON of Indiana, Ms. RIVERS, Mr. LIVINGSTON, Ms. ROYBAL-ALLARD, Mr. QUINN, Mr. YATES, Mr. WAMP, Mr. SANDERS, Mr. HINCHEY, and Mr. CARDIN) introduced the following bill; which was referred to the Committee on Banking and Financial Services

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A BILL

To amend the Federal Credit Union Act to clarify existing law and ratify the longstanding policy of the National Credit Union Administration Board with regard to field of membership of Federal credit unions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Credit Union Membership Access Act".

The first page of the two-page original H.R. 1151 bill introduced by Representatives LaTourette and Kanjorski. (Document Courtesy Bill Donovan.)

LaTourette and Kanjorski urged the committee to maintain the narrow fix." All we do in H.R. 1151 . . . is codify the unanimous bipartisan position of the National Credit Union

Administration that was followed under the Reagan Administration, the Bush Administration, and the Clinton Administration, and which contains no extraneous material," Representative Kanjorski told his fellow committee members.

Credit union witnesses led off the hearing, starting with Donald W. Lewis, president and CEO of Aberdeen Proving Ground Federal Credit Union, Aberdeen, Maryland, on behalf of NAFCU. He said: "Since 1982, a number of credit unions across the country, following the direction of the Federal Government, began serving more than one group of members . . . We believe that this policy made sense then and that it makes sense now; just ask any member of the 25 Select Employee Groups at my credit union.

"We are not coming here today asking for anything new. We are not seeking new powers; we are not seeking new expansions. All that credit unions are asking is that you take action to uphold that policy."

He pointed out that credit union competition was not hurting bank profits. He went on to discuss bank demands for taxation of larger credit unions and imposition of Community Reinvestment (CRA) requirements.

"The Federal Credit Union Act requires credit unions to serve their entire membership, and because credit unions were not a part of a history of a series of complaints of red lining, complaints about discriminatory practices, it is very hard for us to understand why CRA is being talked about within the credit union context.

"On taxation, my response is quite simple: Credit unions are not-for-profit financial institutions run by volunteer boards for the public good."

The next witness, on behalf of CUNA, was Rose Bartolomucci, president and CEO of state-chartered Kent Credit Union, Kent, Ohio.

"My belief, Mr. Chairman, in the credit union difference runs deep. Both my parents were immigrants. My father spoke little English when he arrived here, and he was turned down by

three different banks for a $2,000 loan to open his own business. He tried St. Anthony Federal Credit Union which was open after mass on Sundays. The loan committee took a chance on him, and that was his start in the American dream and my start as a credit union believer . . . .

"Even though my credit union is not affected right now by the Court ruling, my participation in these hearings should make it clear that all credit unions are extremely concerned by what's happening. Most importantly, the potential restriction on credit union membership is not really about any institution, it's about consumers and their right to determine where and how they conduct their financial affairs."

The viewpoint of businesses that supported the legislation was offered by Gale Briles, industrial relations manager with Klaussner Furniture, one of the select employee groups served by AT&T Family Federal Credit Union. She was a board member of a coalition of more than 1,000 large and small businesses and organizations that had been formed as part of the Consumer Choice Campaign.

"I'm here to represent employees who need the choice of a credit union," Ms. Briles told the committee. "I'm talking about 62 million Americans in mid to small size businesses like hardware stores, metal shops, shoe factories, window manufacturers, daycare centers. These groups cannot form their own credit unions. It takes at least 500 members to do that, and they are the folks who need it the most. On average, employees of small to mid-size firms earn significantly lower wages, and they're much less likely to receive help in pension benefits."

Also testifying at the hearing were representatives of two of the major banking associations, the American Bankers Association (ABA) and the Independent Bankers Association of America.(IBAA).

"(It) is not our intent to make widows or orphans out of any current credit union customer," testified the IBAA's K. Reid Pollard of Randolph Bank and Trust Company, Asheboro,

North Carolina, one of the banks that had initiated the field of membership suit against NCUA..

While the bankers agreed that current credit union members could be permitted to retain their memberships, they called on Congress to tax multiple group credit unions, remove their exemption from state income taxes, and impose Community Reinvestment Act requirements on them. In addition, any credit union, whether single or multiple bond, that had commercial accounts would be taxed and placed under CRA.

"Credit unions wishing to associate with groups unrelated to the credit union's original common bond or wishing to serve commercial customers are in principle no different than the 800 mutual banks and thrifts and should be treated as such," argued the ABA's Jeff Plage, of First National Bank, Waverly, Iowa.

On March 26, 1998, the House Financial Services Committee met in open session to mark up H.R.1151—that is, to consider and vote on proposed amendments.

The mark-up session proceeded slowly, and it soon became clear that the single-sentence "quick fix" would go by the board. Amendment after amendment was added. By the time the committee had finished its mark-up and prepared to vote, the bill had grown from two pages to 35 pages, with provisions dealing with field of membership, credit union financial reports and auditing, conversion of credit unions into other types of depository institutions, business lending, serving people of modest means, NCUA Board appointee requirements, capitalization, and net worth standards.

The tension in the room was palpable, CUNA's Dan Mica recalled. The committee broke to take care of a House floor vote, and the chairman, Jim Leach (R-Iowa), took Mica aside and told him that as of that moment, the committee was one vote shy of the necessary votes to pass the bill. He advised Mica that if the vote went against credit unions, the banks had a series of additional amendments lined up "that would have

dismantled the credit union movement" and Leach would be unable to stop it.[319]

Mica turned to the league presidents with him, and urged them to contact the committee members from their states or their staffs during the break and try to pick up the needed vote. The final push was successful. When the committee returned, it approved the bill by a voice vote and sent it on to the full House.

On April 1, 1998, after 40 minutes of debate, the House of Representatives approved the bill 411-8. It was sent to the Senate for consideration.

The progress of the bill through the Senate was, to anxious credit unions, agonizingly slow. The Senate Banking Committee held a hearing at which the same arguments were presented as were heard by the House Banking Committee. Then it recessed for spring vacation.

When the Senate returned and held a mark-up session, it added 59 more pages of amendments to H.R. 1151. But the central thrust of the legislation—to preserve the right of credit unions to add SEGs—remained firm.

The movement had a narrow escape, however, from CRA requirements. The committee deadlocked 9-9 on the CRA amendment—but Chairman Alfonse D'Amato (R-New York) broke the tie by casting his vote against the provision.

On April 30, 1998, the committee passed the bill 16-2 and reported it out to the full Senate. But there it languished through May and June. Chairman D'Amato called on the credit union movement to hold a rally on Capitol Hill to urge the Senate to pass the bill before the August recess.

Within a week, thousands of supporters were heading to Washington, D.C., by car, bus, train, and plane. Some 6,500 enthusiasts gathered on Capitol Hill on July 14 to listen to lawmakers speak and to chant "1151."

The Senate heard the chant—on July 28, the lawmakers approved the bill 92-6. To avoid a conference committee, the

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[319] Mica, Dan, Interview, April 12, 2011.

House accepted the Senate version of the bill by a resounding voice vote, and the Credit Union Membership Access Act (CUMAA) went to President Clinton to be signed into law on August 7.

The massive rally before the Capitol helped move H.R. 1151 to final passage. (CUNA/Credit Union Magazine Photo)

Despite being outspent 14-1 on the issue by the banking industry, credit unions accomplished passage of 1151 through unity, grassroots action, and skillful lobbying on the Hill. The leagues had played a vital role in building grassroots support, and it was evident that they retained their importance in the post-Project Renewal world.

The extent of the victory was seen when a respected financial trade association (not the ABA or IBAA) approached Dan Mica to lobby for it at twice the salary he was receiving from CUNA. He declined. By that time, he was a firm believer in the credit union cause.

The passage of the Credit Union Membership Access Act (CUMAA) did not simply maintain the status quo. It presented

new challenges to the movement that would trigger continuing lobbying efforts by the credit union trade associations.

Chapter 56

Field of Membership Changes

The credit union movement achieved its main objective with the passage of the Credit Union Membership Access Act (CUMAA)—preserving multiple group credit unions.

CUMAA grandfathered in existing select employee groups. It further established three distinct types of credit unions:

(1) Single common-bond credit unions. Single common bond credit unions are credit unions comprised of a single group having "a common bond of occupation or association."

(2) Multiple common-bond credit unions. "Only a group with fewer than 3,000 members shall be eligible to be included in the field of membership" of a multiple common-bond credit union. However, the Act allows NCUA to approve any group that "could not feasibly or reasonably establish a new single common bond credit union."

(3) Community credit unions. A community credit union is comprised of "[p]ersons or organizations within a well-defined local community, neighborhood, or rural district."

The community charter, which in the old days was not all that common, became increasingly significant after passage of CUMAA as more credit unions switched to community charters or merged with existing community credit unions. By the end of the period covered in this book, community charters comprised 28 percent of all credit unions, with 38 percent of all members and 36 percent of the movement's assets.[320]

Several months after passage of the Credit Union Membership Access Act, in December, 1998, NCUA published a regulation on standards for chartering multiple common bonds. Banks promptly challenged the new regulation, saying

[320] "The Evolution in Chartering: How Community Charters Have Changed Credit Unions," Credit Union Journal, June 20, 2011, p. 13.

it violated CUMAA. They were joined in the suit by one credit union, Irondequoit Federal Credit Union, Rochester, New York, which, among other complaints, argued that NCUA had failed adequately to protect "'small credit unions from competition with larger, overlapping credit unions." The courts, however, upheld the new standards.

In the 12 months following the new regulation, federal credit unions added 16,290 new groups to their fields of membership.[321]

While CUMAA answered the movement's immediate need, some of the amendments to the original one-sentence bill posed problems for credit unions. As a result, CUMAA helped set the legislative agenda for the movement over the next decade.

Chapter 57

Reserves and Prompt Corrective Action

During the first half of the 1980s, the federal commercial banking regulators, i.e., the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of Currency (OCC) acted to require banks to maintain a minimum capital to assets ratio.

In 1991 the Federal Deposit Insurance Corporation Improvement Act (FDICIA) adjusted the system to take into account the riskiness of a bank's assets. It required Prompt Corrective Action (PCA) when a bank's capital ratio fell to dangerously low levels. PCA might include restricting asset growth, transactions with affiliated banks, and interest paid on deposits. The credit union movement succeeded in having a PCA provision applying to credit unions stripped from the 1991 bill.

Until passage of the Credit Union Membership Access Act in 1998, U.S. credit unions were not subject to any formal capital requirements. Instead, NCUA required them to transfer

[321] Matz, Deborah, "Chairman's Statement," NCUA 1999 Annual Report, p. 11.

a percentage of income each quarter into a reserve account. The level of reserves (also called net worth) was among the factors used by NCUA in calculating CAMEL safety and soundness scores.

Over the years, credit union reserves gradually increased. The average credit union capital to asset ratio rose from 6 percent in 1980 to 10 percent by 1995. Credit unions were generally as well capitalized as thrifts and banks.

However, the General Accounting Office (GAO) in 1991 and the Treasury in 1997 recommended that the NCUA should introduce net worth requirements backed up by a system of Prompt Corrective Action. The Credit Union Membership Access Act (CUMAA) of 1998 provided for this, to be implemented in August 2000.

NCUA henceforward would set capital standards as follows:

Credit unions with a capital ratio of at least 7 percent were considered well capitalized. Those with ratios between 6 and 6.99 percent were considered adequately capitalized.

Those with less than 6 percent were considered under-capitalized. They were subject to Prompt Corrective Action—required to take progressively more severe actions to bring their capital up to an adequate level.

Because credit unions cannot access outside capital, they must generate reserves from their earnings. To accommodate this, NCUA set somewhat more liberal capital standards for new credit unions.

But a more stringent capital requirement was placed on so-called "complex credit unions"—credit unions above $10 million in assets that were assuming greater than average risks, such as deeper involvement in business lending.

Objections to PCA by credit unions were immediate and sometimes vociferous. They worried that a fast-growing credit union's assets could temporarily outstrip its capital formation and trigger PCA.

Former NCUA Chairman Ed Callahan, then president and CEO of Patelco Credit Union in San Francisco, argued that

NCUA's broad definition of complex "can come back to bite in a thousand ways, and the worst will be where it can do the greatest damage, that is, when a credit union is successful. It is when a credit union grows and prospers that it will top the list of "complex" so that it would then fall prey to Prompt Corrective Action. Success itself—including bigness and mergers—will be punished. And that is another death knell for the credit union movement."[322]

Chapter 58

Business Lending

As mentioned earlier, NCUA first imposed regulations on business loans to members after the Hyfin Credit Union debacle in 1987. However, losses to the federal insurance fund due to commercial lending continued, and NCUA tightened its regulations in 1991. These regulations, combined with improving economic conditions, greatly reduced losses to the fund from this source.

But in writing the Credit Union Membership Act (CUMAA), Congress imposed a further restriction on member business lending—that ordinarily it should not exceed 12.5 percent of a credit union's assets or 1.75 percent of its reserves, whichever was less. (The relatively few credit unions that had traditionally exceeded this limit, were allowed to continue, however, and the National Federation of Community Development Credit Unions was also able to get low-income credit unions exempted from the cap.)

Moreover, the act did not require that every loan for a commercial purpose be counted as a business loan by NCUA. Loans to an individual totaling less than $50,000 were exempted, and as well business loans:

- Fully secured by a primary family residence accommodating 1 to 4 households;

[322] Callahan, Ed, "Disaster Looming in a Word Called Complex," Creditunions.com, June 5, 2000.

● Fully secured by shares in the credit union making the loan or deposits in another financial institution;

● Loans fully insured, or fully guaranteed, or where there is an advance commitment to purchase in full by any agency of federal, state, or local government; and

● Loans granted by a corporate credit union to another credit union.

At the time CUMAA was enacted, member business lending made up only about one percent of credit union lending. However, the 12.5 restriction did not go over well with the credit union community, especially the larger credit unions that were doing the bulk of business lending.

What types of member business loans were credit unions making? First of all, credit union business loans were different in some ways from many of those made by banks. They:

● were only made to credit union members;

● generally required the personal guarantee of the borrower; and

● usually had to be fully collateralized, i.e. secured by property or something else of value.

According to a Treasury study mandated by CUMAA, 1,514 credit unions had business loans on their books as of June 30, 1999. These lenders comprised 14 percent of all federally insured credit unions and were mostly the larger ones.[323] Slightly more than half of credit unions with more than $250 million in assets had member business loans, compared to less than 5 percent of those under $10 million.

Business lending was more concentrated than even those figures suggest. The Treasury study found that 92 credit unions had business loans exceeding their capital. Their loan portfolios comprised 46 percent of all member business lending in 2000.

Member business loans went largely to small businesses—small landlords, taxi drivers needing to purchase medallions,

[323] U.S. Treasury, Credit Union Business Lending, January, 2001.

and farmers. The study noted that many of those receiving business loans were of modest income:

"Our survey results showed that 25 percent of member business loans were made to members with household income of less than $30,000—and that these loans totaled 13 percent of the outstanding member business lending balances. Another 20 percent of the loans (with 15 percent of the outstanding loan balance) went to households with incomes reported to be between $30,000 and $50,000."

The study found that credit union business loans were generally less risky than those made by banks and thrifts and posed little threat to the federal insurance fund.

Chapter 59

D'Amours Proposes Low-Income Regulation

Norman D'Amours' term as NCUA chairman ended in August, 1999, but he followed Robert Swan's example by refusing to step down until a replacement board member was approved.

While the movement had narrowly escaped being included in the Community Reinvestment Act (CRA) in the negotiations over the Credit Union Membership Access Act, D'Amours in July of 1999 proposed what many credit unions considered a close relative of CRA. The proposed rule would have:

- required all but the smallest credit unions to draw up a business plan on how they would serve their potential low-income members;
- given NCUA oversight of how the plan was carried out, and
- made NCUA's evaluation of the credit union's implementation a factor in approving a request by the credit union to change its charter

D'Amours argued that the proposal was not a credit union CRA, that it simply asked credit unions to report how they would reach out to low-income groups in their fields of

membership. But the proposal was opposed vigorously by the credit union movement, which felt that NCUA's role was to protect safety and soundness, not oversee the social mission of credit union. "There's no evidence credit unions need a rule like this," said CUNA President Dan Mica. "At a time when the prevailing view in Washington is for less rather than more regulation, why invoke a new federal mandate when credit unions are already doing this?"[324]

When D'Amours introduced his proposal formally to the NCUA board in September, 1999, board member Yolanda Wheat argued that some language should be modified. Dennis Dollar flatly opposed it. As a result, the proposal failed for lack of a second. But the idea was not dead, as the new century would show.

In November, at the behest of Yolanda Wheat, the NCUA board voted 2-1 to send out a one-time survey asking federal credit unions what they were doing to serve people of modest mans. D'Amours voted against it because responding was voluntary, not mandatory.

The credit union community objected strongly to the survey, arguing, as NAFCU put it, that NCUA was "first and foremost, a regulator of the safety and soundness of credit union operations, not their social mission."[325]

The Office of Management and Budget, which reviews the federal government's data collection practices, put a crimp in the plan, arguing that the voluntary nature of the survey would likely "generate only anecdotal and potentially biased results," as OMB's Alexander Hunt would tell NCUA's Director of Administration after the turn of the year.[326] The survey was never sent, but pressure on NCUA from Congress to gather such data would continue over the following years.

In October 1999, NCUA board member Dennis Dollar said he was working on a "Reg-Flex" proposal to lighten the

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[324] "The D'Amours Plan," Credit Union Magazine, September, 1999, p. 40.

[325] NAFCU comment letter to NCUA, December 11, 1999.

[326] "Dateline Washington," Credit Union Times, April 26, 2000.

regulatory burden for credit unions that met certain safety and soundness requirements.

Dollar had served as the chief executive officer of the $31-million asset Gulfport VA Federal Credit Union in Mississippi and as a state lawmaker before his appointment to the board in 1997.

He had a very different approach to regulation than Chairman D'Amours. As he told NAFCU's Congressional Caucus in 1999:

"I am asked often what I feel is the primary role of NCUA as regulator and insurer. Are we the arbiter of disagreements among credit unions who are part of a cooperative movement? Are we the evaluator of member service, both its adequacy and its quality? How about the social conscience of individual credit unions, are we the compliance officer to determine how deep that social conscience goes or if the credit union is doing everything it can to fill its own social contract between the credit union and its member-owners?

"I would say the answer is "no" as to whether any of these is the primary role or even a proper role for a federal regulator. Either credit unions value their cooperative structure and work together for the good of the overall movement or they do not. Either they believe in their social mission or they do not. It cannot be imposed from the outside. And certainly it cannot be government imposed."[327]

His Reg-Flex proposal, he told the Caucus, was "based upon my belief, honed in the trenches of the credit union movement as a former credit union manager and re-enforced through the difficult policy and safety and soundness issues I have dealt with in my two years on the NCUA Board, that safe and sound credit unions with solid capital levels and high CAMEL ratings have earned more regulatory flexibility, hence the name REG-FLEX." This, he said, would allow NCUA to focus more resources on credit unions truly needing attention. Formal introduction of his proposal was slated for 2000.

[327] Dollar, Dennis, "Regulatory Empowerment for America's Credit Unions," Remarks to NAFCU Congressional Caucus, October 6, 1999.

Chapter 60

The Dot-Com Bubble

As the year 2000 approached, America was having a romance with technology. The U.S. had experienced the longest uninterrupted period of economic expansion in its history during the 1990s. Business gurus were proclaiming that the United States had entered a "New Economy" due to the changes being wrought by computers and the Internet. Unlimited growth and prosperity lay ahead.

Credit unionists wondered if they could keep pace with developments. Would traditional depository services be swept away by the newly chartered Internet banks that had no bricks and mortar to support?

There was debate in credit union circles over whether it was better to be on the "bleeding edge" of technological advances, where mistakes could be costly, or to be "fast followers," adopting technology once it was proven effective. As it turned out, credit unions often were faster to adopt new technology than banks.

"The larger ones, those that have $20 million, $50 million or more in assets, are usually ahead of banks," noted Andrew Mallon, publisher of Credit Union Technology magazine. "Because they're nonprofit, they can't afford the big staffs and they look to technology for efficiency. The really major point is the credit union's sole purpose is to serve the members, not to make a profit."[328]

Credit unions, meanwhile, were slowly discovering that the electronic networks that now controlled essential functions of American life, from defense to airplane flights to nuclear plants to financial institutions, were vulnerable to hackers and criminal "crackers" who launched millions of attacks each day. These might emanate from Hoboken, Beijing, Bucharest, or the Middle East. Computer and Internet security lagged behind

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[328] Mallon, Andrew, in "Credit unions lead the way in high-tech banking," Bankrate.com, August 7, 2002.

the threat, and institutions and individuals were forced to play catch-up in protecting their electronic records.

Outside the reasonably sober discussions about technology within the movement, Americans were riding a wave of euphoria about the economic paradise that seemed to lay just beyond the horizon. This took the form of rising prices for stocks that were in some way connected with the Internet. Americans were entering into the greatest stock market mania of our history.

The average valuation of U.S. stocks had been roughly equal to 55 percent of the nation's annual output, the Gross Domestic Product (GDP). By 1995, stock valuations had risen to 83 percent of GDP. In 1996, Netscape, the maker of the then popular web browser Netscape Navigator, went public. Jim Clark, the company's founder, made an instant fortune of half a billion dollars. "It was the first great strike of Internet gold, and the market and the media were agog," wrote financial journalist Peter Hartcher in his book on the Internet frenzy. That year, stock valuations reached 100 percent of GDP.[329]

Thousands of people quit their jobs to become "day traders," using sophisticated stock trading programs on their home computers to bet on the rising market. At the beginning, many made money. At the end of the boom, most went back into the job market, thousands of dollars poorer.

Federal Reserve Chairman Alan Greenspan and others in the Fed saw a stock market bubble forming. Greenspan warned of "irrational exuberance," and the stock market hesitated, then resumed its upward progress. The Fed took no action. Greenspan saw its role as controlling the money supply, not asset bubbles.

Much of the frenzy in stocks was based on fledgling Internet companies like Netscape that promised their shareholders extravagant future growth. The idea was to attract venture capital with a good-sounding idea, such as selling pet food or toys over the Internet, and then reach a

[329] Hartcher, Peter, *Bubble Man: Alan Greenspan and the Missing 7 Trillion Dollars*, W.W. Norton, New York, London, 2006.

point where the dot-com, as this sort of company was dubbed, could go public and make its stock-holding founders and employees and early investors rich.

By 1999, stock valuations had reached 170 percent of GDP, three times their traditional value. Adding fuel to the fire was a massive boost in technology investments by business and government dictated by the threat of Y2K.

Chapter 61

Y2K—Will Civilization Collapse?

Larry Wampler, 52, of Happy Valley, California, was prepared for the worst. The survivalist cut his use of electronic gadgets to the minimum. If civilization broke down, he figured he had enough stockpiled supplies to last two years, he told a Scripps-Howard reporter.[330]

Nancy O'Rourke, 51, vice president of the credit union serving the Oak Ridge atomic weapons plant, was less concerned. "I believe there will be minimal impact. My biggest concern is the misconception people may have that there will be major problems"[331]

They represented the range of opinions Americans held about the Y2K "bug."[332]

Y2K was shorthand for the Year 2000. And the bug was a legacy of the early software writers. As those writers developed programs, they took into account the limited data storage space of the early computers by representing years with two digits rather than four—July 4, 1963, for example, would be represented by 070463 rather than 07041963. As computers became more capable, software developers believed, their two-digit "kludge," to use the computer nerd's expression for an ad

[330] "Y2K preparation tied to personal views," Scripps-Howard News Service, July 4, 1999.

[331] Ibid.

[332] This wasn't a true software "bug," but an intentional design feature used by early software developers.

hoc fix, would no longer be needed and would be either adjusted or eliminated.

But they underestimated human and technological inertia, and as the century neared its end, many of the mainframe systems used by governments, banks, and insurance companies still had, at their core, legacy code that used two-digit years. The question was, how would computers handle the change of centuries?

Would the year 2000, represented by "00," be interpreted as 1900? Would computer functions dependent on dates, such as those employed by the financial sector, become hopelessly confused, leading to breakdown? It was little wonder that the Y2K problem rang alarms through the credit union world as the word slowly trickled out.

The first mention of the threat in a mass circulation publication was a 1984 article in Computerworld that did not attract much attention. Peter de Jager, who thought of himself as a Y2K prophet, began sounding the alarm in a 1993 article in the same magazine, predicting it would cost $75 billion to remediate.[333]

By that time, the big insurance companies and other financial institutions that used old code already had major projects under way to rewrite their systems. But most government agencies, non-financial businesses, and average Americans began to be really concerned in the last half of the 1990s.

"When the clock strikes midnight on December 31, 1999, many computers could malfunction or even shut down," declared Chairman Jim Leach (R-Iowa) of the House Financial Services Committee, at a 1997 hearing on the problem.

"At financial institutions, it could mean errors in checking account transactions, interest calculations, or payment schedules. It could mean problems with ATM systems or credit and debit cards. It could affect bank record keeping,

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[333] "Everything You Wanted to Know About Y2K," Computer World, December 28, 1999.

investments, currency transfer, and legal liability. It might interfere with payment systems, both here and abroad, and affect EFT (electronic funds transfers) transfers for payroll or pension recipients. It takes little imagination to picture the ricochet effects that malfunctioning computer systems could have on important bank operations."[334]

By the time this hearing was held, serious efforts were under way in the credit union movement and financial services in general to ward off the threat. For some institutions, it meant reprogramming their computers to eliminate the bug. This was difficult and time-consuming. Many institutions, including credit unions and their organizations, replaced computer systems with systems that were certified as "Y2K Compliant." Vendors like share draft processors also had to be double-checked to make sure they they corrected the bug in time.

Ultimately, the switchover cost the movement millions of dollars. Tropical Federal Credit Union, Miami, for instance, had expended more than $950,000 by 1999 for new equipment and software and other expenses.[335] And for the U.S. as a whole, the cost amounted to some $100 billion, the U.S. Department of Commerce estimated.[336]

As 2000 approached, U.S. credit unions were well prepared for the millennium transition. "We are proud to inform you that La Cap (FCU) is 'Y2K' ready. We have been working on the Year 2000 issue since 1997, when we began identifying and investigating all systems that could be affected, including vendors and proprietary software. All of our computers and programs have been converted, upgraded, replaced or redeveloped and thoroughly tested," Betsy Hooper, president of

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[334] "Millennium Bug: Banking and the Year 2000 Computer Problem," Hearing of the House Banking and Financial Services Committee, November 4, 1997.

[335] "Countdown to Y2K," Credit Union Magazine, July, 1999, p. 61.

[336] "The Economics of Y2K and the Impact on the United States, U.S. Department of Commerce, November 17, 1999, p. iii.

La Capitol Federal Credit Union in Baton Rouge, Louisiana, informed her members on the credit union's web page.[337]

Credit unions' main concern now was how their members would react to sometimes alarming media predictions. Would they draw out three months' worth of cash before January 1, as one "expert" suggested? The corporate system stood ready to lend to credit unions that felt the need to bolster their reserves of cash for member withdrawals. In addition, the movement had won congressional approval for a $20.7 billion line of credit for the Central Liquidity Facility for lending to corporates or individual CLF-member credit unions, if needed.

At America First Credit Union, Salt Lake City, Utah, a member was so worried he withdrew $20,000 and stuffed it into his pants. The branch manager reassured him that his funds were safe, and he returned the money to his account.[338]

To reassure his members, Alex Knaver, president of Bethlehem Employees' Federal Credit Union, Chester, Indiana, encouraged them in his newsletter column to visit the credit union during the last week of 1999 to get a printout showing the balances of all their credit union relationships.

"It seems simple, but I think it can help them feel like they've taken some action to protect themselves," said Knaver. "I'd rather have them swarm the branch for statement printouts, than for cash."[339]

At La Capitol, president Hooper wrote:

"La Cap suggests our members do make preparations—sensible, reasonable preparations. La Cap is certainly making our own preparations to ensure our members' records and accounts are well protected and accessible, and we suggest our members make similar preparations.

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[337] Hooper, Betsy, "A private note to our members," http://www.lacapfcu.org /y2k.htm

[338] "Credit union counsels members against Y2K panic," Salt Lake City Enterprise, March 22, 1999.

[339] "The Y2K homestretch: CUs ready to battle the media in war of words over the reality of Y2K." Credit Union Times, August 17, 1999, reprinted at greenspun.com.

"I am personally preparing as I would for a Louisiana hurricane:

1. "I will check my pantry to be sure I have a couple of days' food.

2. "I will be sure my prescriptions are refilled.

3. "I will buy an extra battery or two.

4. "I will have a supply of water.

5. "I will not let my gas tank be empty.

6. "I will also have some extra cash."

By "extra cash," she told members, she meant $100.[340]

But, "We have not heard too much from our members," Joe Veneziani, president of Group Health Credit Union in Seattle and a Washington League board member, said. "It's still early, but what we've found is our savings have been increasing. This is why I feel real confident."[341] As it turned out, most credit unions did not encounter high cash withdrawals.

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[340] Hooper, Betsy, "A private note to our members," http://www.lacapfcu.org/y2k.htm.

[341] "After Years of Preparation, Financial Industry Nearly Ready," Seattle Times, May 17, 1999.

The 2000s
Decade of Disasters

Chapter 62

A New Millennium

In many credit unions, leagues, and at CUNA, data processing professionals and officers stayed up all night New Year's Eve, 1999, to deal with any Y2K problems. But New Year's Day came and went, and no serious problems were reported.

In February, 2000, the Senate Special Committee on Y2K listed more than 50 incidents in the U.S. and more than 100 elsewhere, most fixed quickly and none considered major. Was this lack of major problems a sign that Y2K remediation programs had been successful? Or a sign that they had been a waste of time and money?

Some clues came from abroad. The greatest remediation efforts had occurred in the United States and other English-speaking countries like Australia. Many other countries, such as Italy, had lagged behind in computer compliance. But those countries reported no more problems as the year changed than the English-speaking world did.[342]

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[342] Quiggin, John, "The Y2K Scare: Causes, Costs, and Cures," Risk & Sustainable Management Group, Australian Public Policy Program Working Paper: 1/P04 February 18, 2004.

Some have concluded that much of the time and money expended on Y2K fixes was wasted. It would have been much cheaper, they say, to have simply fixed problems as they arose, as was customary in dealing with other computer problems. [343]

On the other hand, the potential harm could not have been ignored, especially by government departments like defense and by key industries like utilities, airlines, and banking. Any organization that simply whistled by the graveyard could have faced possibly severe service disruptions and potential legal liabilities. In any case, much of the work and expense that went into Y2K preparations would have occurred over time anyway as systems were upgraded.

New Year's Day of 2000 found the credit union movement in excellent shape, with the coming recession still over the horizon.

Due to the buoyant economy of the later 1990s, credit union loan growth of 10.5 percent during 1999 was the strongest since 1996. Savings grew more slowly, by 5.0 percent. As a result, the loan to share ratio rose to 71.6 percent.

New and used auto loans continued to be a major source of income for credit unions, comprising 39 percent of their total loan portfolio. But first mortgage and other real estate loans were now equally important at 39 percent. Most of the remaining portfolio was in credit card balances (7 percent) and other unsecured loans (8 percent).

Member bankruptcy, while a continuing concern, was a relatively minor problem in the overall picture. The Bankruptcy Code had been amended once again in 1994, without greatly changing the situation. In 1999, however, as the nation basked in its economic boom, the number of members filing for bankruptcy fell 12 percent. Although 214,700 members with nearly $1 billion in loans filed for bankruptcy, this represented only 0.3 percent of all members. Total loan delinquency fell to 0.75 percent of the loan portfolio, the

[343] Ibid.

lowest rate in the history of federally insured credit unions. And net charge-offs declined to just 0.49 percent of all loans.[344]

Profitability remained stable for federally insured credit unions, with a return on assets ratio at yearend 1999 of 0 .93 percent.[345]

Capital, the measure of a credit union's ability to withstand economic shocks continued to grow. The capital to asset ratio, which had stood at 6 percent in 1980 now stood at 11.4 percent, better than the banking industry, which was at around 8 percent.

The credit union share of household savings in depository institutions and money market funds had grown through the decades, from 4.4 percent in 1980 to 8.5 percent in 1999. Due to many Americans putting money into stocks and other non-depository investments, the credit union share of total household assets had declined slightly, from 1.4 percent in 1980 to 1.3 percent in 2000.

Consolidation was continuing, though less rapidly than in the banking sector. The number of credit unions in the United States had fallen by nearly half since 1980, from 21,465 to 11,016 at yearend 1999.

But membership had risen, from 43.9 million in 1980 to 77.5 million. This represented about 26 percent of the U.S. population, or 30 percent of the economically active (adult) population. Growth in membership in recent years, however, had been largely confined to state charters, due to the freeze placed on growth of federal charters by the courts.

Assets had grown even faster than membership, from $72.3 billion in 1980 to $422.6 billion at yearend 1999.

Most of the growth in membership, assets, and services

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[344] A loan is considered delinquent if payment is overdue by 2 months or more. A charge-off occurs when the credit union writes off a loan as unlikely to be repaid.

[345] As noted earlier, net income divided by assets, known as return on assets (ROA), is a common indicator of how well a credit union is doing economically. ROA in the 1990s fluctuated around one percent, considered a good return on assets.

was concentrated in larger credit unions. For instance, less than half of the credit unions under $100 million offered more than auto loans. While some 40 percent in this asset group offered first mortgage loans, this compared to 100 percent of credit unions over a billion dollars in assets.

In January 2000, Ken Robinson retired as president and CEO of the National Association of Federal Credit Unions (NAFCU) after 16 years of leading the organization. His successor was Fred Becker, a retired Navy captain with a legal background who had been Naval Affairs director for the Reserve Officers Association of the United States.

The new millennium saw continuing frustration with NCUA. Chairman D'Amours continued to irritate the mainline credit union movement through his manner and his insistence that NCUA oversee the social mission of credit unions.

In June, 2000, Community Reinvestment Act-lite sprang back to life, albeit now applying only to community federal credit unions. The reader will recall that the CRA required banks to make loans in communities where they obtained deposits and forbade "red-lining," or avoiding low-income neighborhoods. The NCUA board proposed to amend its chartering and field of membership manual to update chartering policies and further streamline the select group application process. The proposal included a provision that any type of application related to expanding, converting, or chartering a community credit union would have to include not only the required business and marketing plan, but also a Community Action Plan (CAP).

The CAP would explain how the credit union intended to service its entire membership. It would need to be periodically updated by the board of directors of the credit union and reviewed from time to time by NCUA. Board member Dennis Dollar tried to get this provision eliminated or at least separated from the other provisions, but he was unsuccessful. Senate Banking Committee Chairman Phil Gramm (R-Texas) also wrote the board asking that this provision be dropped.

Most of the other provisions in the NCUA proposal received

support from the credit union community, but the CAP provision was vigorously opposed. Nonetheless, a slightly revised version went into effect November 27, 2000.

Meanwhile, President Clinton nominated Geoff Bacino to the NCUA Board in July of 2000 to take D'Amours' seat. Bacino was president of Bacino and Associates, a Washington lobbying and public relations firm. In previous years, he had worked for a number of credit union trade associations.

The Senate did not act on the nomination and D'Amours stayed on. Finally, on December 28, 2000, D'Amours resigned.

The next day, Clinton, ending his second term after the November election of Republican George W. Bush, promoted Board member Yolanda Wheat to the chairman's post. He made a recess appointment of Bacino as the third board member.

Wheat's chairmanship lasted just a month until the new GOP president exercised his prerogative to designate which board member chaired the NCUA Board. He elevated Dennis Dollar to the post. Wheat continued as a board member until her term ended in August, 2001. President Bush named Jo Ann Johnson, an Iowa state senator, to succeed her. Johnson happened to be a daughter of Don Johnson, who had served as Chairman Roger Jepsen's executive director.

The new NCUA administration repealed CAP in December, 2001, with the enthusiastic support of the credit union community. It also enacted Dennis Dollar's Reg-Flex proposal that, in his words, permitted "credit unions with advanced levels of net worth and consistently strong CAMEL safety and soundness ratings to be exempt, in whole or in part, from certain NCUA regulations that are not specifically required by statute nor required for safety and soundness purposes when applied to a credit union with such an advanced capital and financial performance position."[346]

He noted that his proposal "has been well received by our

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[346] Dollar, Dennis, Statement before House Subcommittee on Financial Institutions and Consumer Credit, March 14, 2002.

stakeholders and has resulted in over 1,400 comment letters—the most ever received on a regulatory proposal issued by NCUA."

Things were also changing at CUNA and Affiliates under the leadership of President Dan Mica. The CUNA Service Group (CSG) credit card processing losses, even after the sale of the business, had put a severe dent in CUNA finances. In addition, Mica, in line with the Renewal Project, had a mandate to focus the trade association more on governmental affairs and less on business operations. To repair its financial status and to support growth in governmental operations, CUNA needed more funds.

With its card business sold, CUNA Service Group's main activity now was supporting credit union Individual Retirement Account programs. With the approval of the CSG board, CSG and most of its remaining businesses were sold to CUNA Mutual, effective January 1, 2000.

Some CSG responsibilities, such as e-commerce initiatives and alliances with endorsed vendors were not transferred to CUNA Mutual but were placed under the control of a new CUNA affiliate, CUNA Strategic Services, Inc. (CSSI).

In addition, Mica won the support of his now broader-based board for a dues increase, from 10 cents per credit union member to 12 cents and from one percent of each $1,000 in assets to 2 percent. Credit unions below $5 million in assets were exempted from the increase.

The new emphasis on advocacy was symbolized by the establishment of "Credit Union House" in Washington, D.C., near the Capitol, paid for by the leagues. Modeled on a similar house set up by the Florida League on Capitol Hill, the structure would provide a place where credit unionists and CUNA lobbyists could meet with legislators and hold other events. Ground was broken in October, 2000.

The landscape for the leagues was shifting now that integration of corporates had ended and as member credit unions grew and became more self-sufficient. Credit unions, especially in larger states, were less interested in buying

products and services from their leagues—although those league functions continued—than in the traditional trade association functions of advocacy, education, and publications.

Some consolidation had started taking place in the 1990s. As noted earlier, after the Rhode Island insurance crisis of 1991, the league there had turned over its administrative functions to the one in Massachusetts. In 1995, the small Nevada League turned over its administrative functions to California. This trend would continue in the new decade.

The Renewal Project diminished the role of the leagues in CUNA governance, but the fight over the Credit Union Membership Access Act showed that the leagues were a significant force in advocacy efforts. These developments led the Association of Credit Union League Executives (ACULE), to shift from being a professional association of league executives to focusing on league improvement and advocacy.

To reflect its new emphasis, ACULE had changed its name in September, 1999, to the American Association of Credit Union Leagues (AACUL). The goal was to help leagues to promote credit union interests more effectively. AACUL chairman Mike Mercer of the Georgia League, said. Rather than work independently, "we've already started identifying which leagues have put together innovative products and services or ways of doing things, and are getting them rapidly understood and embraced either in practice or by sharing resources throughout the whole system. That will be our modus operandi."[347]

Leagues, credit unions, and CUNA saw the importance of the Internet. They were establishing web pages of varying sophistication and adding web-based access to their services. CUNA's former dial-up Meteor System was now a web site, cuna.org (or alternatively today, cuna.coop). More and more of CUNA's publications, such as the weekly Credit Union News Now, were becoming available on-line, along with training programs.

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[347] "ACULE refocuses role; changes name," CUNA Credit Union Newswatch, September 22, 1999.

The dot-com stock bubble reached its apex in March of 2000 when the NASDAQ reached its all-time high of 5,048, double its value the year before. Stock markets in other countries were also soaring.

A few firms, like eBay, Google and Amazon, fulfilled their early promise. But many ventures into the new age of Internet commerce failed. It soon became clear that the Internet was not the yellow brick road to riches. The price of capital also was rising as the Federal Reserve raised interest rates, making it harder to find start-up money. The dot-com bubble collapsed over the next two years, with stocks losing a third of their value—some seven trillion dollars vanishing from American pension funds and other savings.

Chapter 63

9/11/2001—Day That Shook the Nation

The sky was almost cloudless, a perfect September day along the East Coast. But aboard American Airlines Flight 11, a hijacking was in progress as Muslim fanatics seized the cockpit.

"Something is wrong. We are in a rapid descent . . . we are all over the place," reported Stewardess Amy Sweeney to American's Flight Center as the plane approached New York City. Asked to look out the window and try to see what was happening, she said, "We are flying low. We are flying very, very low. We are flying way too low." Seconds later she said, "Oh my God we are way too low."

The phone call ended. Less than two minutes later, American 11 smashed into the north tower of New York's World Trade Center and exploded in a ball of flame. In the 39th floor offices of XCEL Federal Credit Union, employees felt the building shake. Chief Financial Officer Sharon Brimmer at first thought it was an earthquake. Looking out the window, she saw objects falling. She had no time to ponder what was happening but began leading employees down the stairs of the skyscraper. "Things were not making sense," she told CUNA's

Credit Union Newswatch. “We were about four floors below the cafeteria, and we recognized cafeteria workers who were members of our credit union. We though it was an explosion in the cafeteria.” [348]

Smoke and dust billow over New York City as the twin towers burn and collapse. (Coast Guard Photo)

As the stairwell filled with fleeing north tower workers, United Airlines Flight 175 flew into the south tower and exploded. A pillar of smoke rose over New York into the blue sky as the twin towers that symbolized U.S. financial and business power burned. Employees of FAA Eastern Federal Credit Union in building six of the complex managed to escape, along with the employees of XCEL Federal Credit Union, before the towers collapsed and destroyed their building.

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[348] Credit Union Newswatch, September 17, 2001, p 1-2.

The tragedy had only begun. At 9:37 a.m., American Airlines Flight 77 dove into the Pentagon in Washington, D.C. A branch of Pentagon Federal Credit Union on the Pentagon's concourse was shaken, but its employees escaped injury.

Another flight, United 93, was apparently heading toward the White House or the Capitol when passengers alerted by cell phone to the ongoing horror, rushed the cockpit to try to wrest back control of the plane. At just after 10 a.m., the pilot hijacker dove the plane into a Pennsylvania field, killing all on board.[349]

Some 3,000 people in all, most of them in the World Trade Center but including many rescue workers, died in the 9/11 attacks. Many of the survivors were injured, suffered traumatic stress, or were sickened by the dust and smoke. It was the modern equivalent of Pearl Harbor. "Our staff and our members saw things that no one should have to see, and experienced things that no one should ever have to experience. So we want to do all that we can to help them with their financial lives and their personal lives," FAA Federal Credit Union CEO Stacey Porter told Credit Union Newswatch.[350]

The credit union movement responded with aid to the victims of the disaster and their families. The New York League's Credit Union Foundation became the lead agency for movement contributions to aid survivors of the disaster. The day after 9/11, the National Credit Union Foundation donated $10,000 to the New York effort. and soon the New York foundation had received half a million dollars. In addition, credit unions around the country serving firemen and policemen raised funds to aid the families of the hundreds of rescue workers lost in the collapse of the twin towers.

Credit unions encouraged members to contribute aid and joined in the patriotic fervor that followed the 9/11 attacks. In

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[349] This bare-bones account is drawn from "The 9/11Commission Report: Final Report of the National Commission on Terrorist Attacks Upon the United States."

[350] Credit Union Newswatch, September 17, 2001, p 2.

Florida, for example, Carla Gomez of FEC Federal Credit Union, Medley, reported:

"Here at FEC Federal Credit Union, our employees dressed in red, white and blue on Friday, Sept. 14. Our employees are also wearing red, white and blue ribbons. We have ordered pins and will sell them in our lobby to members and then donate the proceeds. We have also ordered 200 candy bars . . . and will do the same with those."[351]

What were the effects of 9/11 on the economy and the credit union movement specifically? The most immediate effect was on the nation's financial sector. More than 50 domestic and international banking and finance firms had offices in the twin towers that were destroyed.

"The attacks on the twin towers threatened the heart of the U.S. financial system," according to a Congressional Research Service report on the aftermath. "Their destruction devastated the leading dealer in U.S. Treasury securities, the loss of whose staff accounted for almost one quarter of those killed in New York City. The debris from the collapsing towers and the general chaos in the area brought about the closing of the New York Stock Exchange, the major stock exchange in the United States, as well as closing brokerage houses and banks in the Wall Street area. The grounding of all air planes severely hampered the clearing of checks and the distribution of paper currency, creating great uncertainty for financial institutions."[352]

However, most of the organizations housed in the World Trade Center or immediately around it had disaster preparedness arrangements in place, such as off-site record storage and "hot sites" prepared to take over computer functions, and they were soon able to function again.

In addition, prompt action by the Federal Reserve and other government agencies helped to prevent the crisis from

[351] "Credit Unions in Florida Respond to Terrorists' Attack," Florida Credit Union News, League Newsletter, October, 2001, p. 1.

[352] "The Economic Effects of 9/11: A Retrospective Assessment," Congressional Research Service, September 27, 2002.

feeding upon itself. "(The) Fed provided liquidity to prevent panic. It injected more than $100 billion into the banking system. It arranged international facilities to keep the global financial system operating. The Fed and central banks around the world cut interest rates and lent money to banks to ease pressures on borrowers," according to the Congressional Research Service.[353]

The short-term impact of the tragedy on the credit union movement was relatively small. The two credit unions involved in the New York events, XCEL Federal Credit Union and FAA Eastern Regional Federal Credit Union, found new quarters and were able to resume operations. In Washington, D.C., Pentagon Federal Credit Union's branch was closed for a few hours, but soon it was open for business again.

New York's Municipal Credit Union, headquartered across the street from the World Trade Center, was forced to move to temporary quarters, and the computer link to its ATMs was severed so withdrawals could not be checked against account balances. Knowing that many municipal workers would need cash, it did not shut down the system.

"We did this at a time of crisis in the city because many of our members are firemen, policemen, and we felt at the time it was a necessary step for us to take to help settle down the city," Thomas Siciliano, the general counsel of the $1-billion-dollar asset credit union, told the New York Times.

Unfortunately, some of its 300,000 members took the opportunity to withdraw more than they had in their accounts. Around 4,000 withdrew at least $1,000 more than they had in their accounts, for a total hit of some $15 million.

The credit union was able to trace these withdrawals to individual account holders and sent out letters demanding repayment. The names of those who ignored the letters were turned over to a collection agency. Most of the members contacted either repaid the money or agreed to convert the overdrafts to loans with deferred payment. But 93 members

[353] "Banking and Financial Structure Continuity: Pandemic Flu, Terrorism, and other Challenges," Congressional Research Service, May 4, 2009.

were charged with stealing more than $7,500 each and refusing to make arrangements for repayment.[354] Most were found guilty or pled guilty. Later, another 118 were charged with stealing more then $5,000 each.[355]

NCUA acted to cushion the shock for credit unions in New York City and in Arlington, Virginia. It activated its disaster relief policy, which hitherto had been reserved for natural disasters. It encouraged credit unions in the two areas to make loans with special terms and reduced documentation to affected members. It indicated it would reschedule routine examinations of affected credit unions, if necessary. And it offered to guarantee lines of credit through the National Credit Union Share Insurance Fund; and make loans to meet the liquidity needs of member credit unions through the Central Liquidity Facility.

The credit union movement, however, was awash in liquidity. As the dot-com bubble imploded, the nation was already in a recession and as a result of falling stock market values and then 9/11, consumers sought safe places to invest their money. This included federally insured credit unions, which saw their savings increase on average by 15.2 percent in 2001. Lending increased more slowly, by 7 percent, and as a result, the loan to savings ratio declined from 79.5 percent to 73.8 percent.

The airline industry along with the travel industry was hit hard by 9/11. Due to the soft economy, air travel and profits were already down before the tragedy. All flights were grounded for four days after 9/11 as authorities sorted out what happened and what threats might still exist. Even after flights resumed, many fewer people were flying. Airlines almost immediately laid off workers and parked unneeded planes. In the U.S. alone, 80,000 employees were idled. losing income and health benefits (although many purchased expensive

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354 "Credit Union Says ATM Users Stole Millions After 9-11," The New York Times, August 6, 2002.

355 "118 Charged in ATM Thefts After 9-11," The New York Times, June 19, 2003.

COBRA policies to fill the gap) and threatened with loss of their homes.

Airline executives appealed to Washington, D.C., for a financial helping hand. "Almost no airline is strong enough to survive for long, facing the upcoming challenges," Delta Airlines CEO Leo Mullin said.[356]

Congress approved and President Bush signed a bill granting the airline industry $15 billion in direct aid and loan guarantees to help it recover. But after losing more than $7 billion in 2001, the major airlines, due to factors like costs of heightened security, rising fuel prices and competition from lower-cost regional carriers, continued to struggle and lose money in the following years.

This obviously posed challenges to the airline credit unions, among the largest in the nation—both in terms of serving laid-off members and facing their own difficulties as it became apparent that the industry was not going to recover quickly. The pool of employees from which they drew their membership was shrinking, and management feared members would lose confidence in the financial viability of their credit unions, even though the credit unions were independent of the ailing airlines.

As a result, one by one the major airline credit unions expanded their fields of membership over the following years to include other groups or switched to community charters.

For example, American Airlines Federal Credit Union, renaming itself AA Federal Credit Union, expanded its field of membership to “the airline transportation industry at large, such as airline employees; government employees including TSA, FAA and others who work directly in administration; regulation or security for airports or airlines; freight and air courier services; baggage; aircraft maintenance; on-board airline food services and more.”

It thus came into direct competition with Northwest

[356] Quoted on CBS News, “Airline Bailout: So, Who Got What?,” December 9, 2002.

Airlines Employee Credit Union, which expanded its field of membership to include everyone in the air transportation industry, under the new name of Wings Financial.

United Airlines Employees' Credit Union expanded to bring some 140 select employee groups into its field of membership and renamed itself "Alliant Credit Union."

Another consequence of 9/11 was that insurance companies began writing acts of terrorism out of their coverage. The exception was CUNA Mutual, the major provider of insurance to the credit union movement. In addition to paying losses of $5 million for the 9/11 catastrophe, it informed its insured credit unions, credit union service organizations, and leagues that it would not exclude terrorism.

Affordable commercial terrorism insurance become unavailable for most other financial institutions and businesses until Congress, in 2002, passed "temporary" legislation that provided government reinsurance for 90 percent of insured losses resulting from certain terrorist acts up to an annual $100 billion industry-aggregate limit. This program was extended, with modifications, in succeeding years of the decade. CUNA Mutual executives served on insurance industry committees that worked with Treasury to shape the legislation.

Chapter 64

The USA Patriot Act

In the wake of 9/11, NCUA at the request of the FBI issued a *Letter to Credit Unions* directing a records search aimed at producing any information on transactions or accounts related to those suspected of participation in terrorism against the United States. And Congress quickly passed the "The United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act," the U.S. Patriot Act, for short.

Among other things, this required credit unions to tighten their identification of members and increased their

responsibilities under the Bank Secrecy Act. "The Act is far-reaching in scope, covering a broad range of financial activities, institutions and businesses, noted three scholars who analyzed it. "The Act was designed to protect US citizens from further terrorist attacks by making it harder for terrorists to launder the money they need to support their attacks, allow government agencies easier access to financial and personal information held by financial institutions, allow federal agents to ask a court for an order to obtain business records in national security terrorism cases and to allow government agencies to freely exchange information."[357]

The act amended at least 34 other laws or regulations, including the Bank Secrecy Act (BSA), the Right to Financial Privacy Act, and the Fair Credit Reporting Act.

For credit unions and other financial institutions, the Patriot Act meant they were required to set up an anti-money laundering program that included: internal policies, procedures, and controls; the designation of a compliance officer; an ongoing employee training program; and an independent audit function.

The act also required stricter identification of applicants for membership, scrupulous filing of Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs), and creation of risk-based assessment plans to satisfy NCUA examiners.

Credit unions and other financial institutions had been required for some years previous to the Patriot Act to file CTRs with the IRS for transactions of $10,000 and above, with certain exceptions. Filling out a CTR is often automated using transaction software. Nearly 15 million CTRs were filed in 2010.

In addition, the SAR was not new. Any transaction involving more than $5,000 that the credit union believed might be linked to criminal activity or was an attempt to

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[357] Carrigan, Martin, Theodore Alex, and Chris Ward, "The US Patriot Act Deconstruction, Civil Liberties And Patriotism," Journal of Business and Economic Research, March 2008.

structure transactions to circumvent federal laws or currency reporting requirements was required to be reported to the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) using the SAR form. FinCEN does not investigate criminal activity itself but passes on the information to other agencies that do. Some 1.3 million CTRs were filed in 2010.

It was not the CTR and SAR forms that presented the challenge so much as the need to document everything the credit union was doing, especially its plans to reduce risk. In addition, it was often unclear even to regulators just what the Patriot Act required.

At the time the Patriot Act was passed, Gigi Hyland was senior vice president and general counsel for Empire Corporate Federal Credit Union in Albany, New York.

"As a person whose job it was to keep a corporate credit union compliant with all applicable regulations, my initial sense of this (Bank Secrecy Act) storm was that the unprecedented onslaught of new requirements and obligations on financial institutions equated to an unattainable goal for credit unions," she recalled in a 2006 speech to a conference on the Patriot Act after she became an NCUA board member.

"The lack of tangible guidance and detail on structuring (of currency transactions) or what constitutes 'suspicious activity;' the dearth of DORs[358] related to BSA on credit union examinations; the enormous regulatory burden; and the uncertainty of where all these (Suspicious Activity Reports) were going and whether they were doing what they were supposed to do – help catch the bad guys – all contributed to my sense that there seemed to be quite a bit of 'B.S.' associated with BSA," she said.[359]

[358] A DOR, or Document of Resolution, is a written statement of how a credit union plans to correct deficiencies noted by its examiner.

[359] "Board Member Hyland Keynotes BSA/USA Patriot Act Conference," NCUA press release on Keynote Address to Credit Union Times – Executive Enterprise Institute Conference on BSA/Patriot Act Compliance, Las Vegas, Nevada, December 18, 2006.

Hyland noted that the burden was shared by all financial institutions. She stressed that a careful and periodic risk-based assessment was the backbone for an effective and cost efficient BSA compliance program. She outlined some sources of helpful information. She reminded the audience of the vital mission of protecting the reputation of the credit union system by continuing to maintain safety and soundness throughout BSA compliance.

The compliance burden was greatest for small credit unions that could not afford to hire compliance specialists, but it meant increased costs for every credit union. Many felt the increased burden was unnecessary. As Greg Blount, president of Tropical Financial Credit Union in Miramar, Florida, put it in a letter to the Credit Union Times after Hyland's speech on the Patriot Act:

"For five years, hundreds of millions of dollars have been expended in implementing, regulating, auditing and complying with the nuances evolving from this well intended government boondoggle . . . . All this time, effort, and money are being squandered to no avail . . . . The road to hell is paved with good intentions. The hellish nightmare that we are experiencing is proof of the truth of that old adage."[360]

In response to such criticisms, James H. Freis, Jr., director of the Financial Crimes Enforcement Network (FinCEN), noted in a speech to NAFCU's Congressional Caucus that:

"I recognize that the financial industry, including your organization and its members, has occasionally raised questions about the usefulness of the information provided to FinCEN. That is a valid concern, and you deserve an answer from your government:

"The information provided through these reports is important and it has been helpful in discovering and building

[360] Blount, Greg, "The Emperor Has No Clothing; Let's Evaluate Anti-Money Laundering Reg Impact – Good and Bad," January 31, 2007, Credit Union Times.

cases against criminals, including those who finance terrorism."[361]

Freis noted the information was used in four different areas:

Tip Off—The information can be the first tip that starts an investigation.

Identifying Information—When an investigation is already underway, the information can add significant value by pointing to the identities of previously unknown subjects, exposing accounts and other hidden financial relationships, or unveiling items of identifying information like common addresses or phone numbers that connect seemingly unrelated individuals and, in some cases, even confirm locations of suspects at certain times.

Trends—Law enforcement investigators, as well as FinCEN analysts, can use technology to examine the entire Bank Secrecy Act information base more broadly. When expertly queried, the data unmasks trends and patterns that hold the telltale signs of criminal or terrorist networks and emerging threats.

This information can also be overlaid on a map to make apparent the geographic range of suspicious activity and allow law enforcement agencies to better allocate their limited resources for maximum effectiveness.

Deterrence—The existence of Bank Secrecy Act regulations has a deterrent effect on those who would abuse the financial system. The certainty of a Currency Transaction Report filing and the mere possibility of a Suspicious Activity Report filing force criminals to behave in risky ways that expose them to scrutiny and capture.

The least efficient way to transfer a large amount of money is using a suitcase full of cash. Drug Enforcement Act and Immigration and Customs Enforcement interceptions of shipments of bulk cash on our borders and highways continue

[361] Freis, James H. Jr., "Remarks to NAFCU's Congressional Caucus," September 10, 2007.

to increase. This demonstrates that criminals fear detection if they use the U.S. financial system and are willing to take great risk to avoid its well-designed capability to detect illicit activity.

Chapter 65

A Nation at War

It was quickly determined that the 9/11 hijackings were the work of al-Queda, the organization founded by Osama bin Laden. The United States, under the administration of George W. Bush, launched a "war on terror" that, in addition to attempts to heighten internal security, soon became a military conflict. The administration went to war first in Afghanistan, which was harboring bin Laden, and then Iraq, claiming that nation had ties to al-Queda and was concealing weapons of mass destruction. After initial victories, both conflicts turned into prolonged guerrilla wars.

Unlike previous major engagements using draftees, the now volunteer Armed Forces had to rely on reserves and National Guard units to fill its ranks. Credit union members called to active duty often found their incomes cut drastically. A person making $100,000 a year in a civilian job could find his or her pay reduced to $30-40,000 annually.

This reduction in income could send already fragile family finances into a tailspin, even leading to bankruptcy or loss of a home. Credit unions needed to be ready to provide counseling to members facing the possibility of call-up to help them deal with financial difficulties. They also could be called on to assist spouses left behind who might not have experience handling the family finances.

In addition, credit unions needed to be familiar with and follow the Soldiers' and Sailors' Civil Relief Act of 1940 (now the Servicemembers' Civil Relief Act) that provides certain financial protections to members of the Armed Services, including reservists and members of the Guard called to federal duty.

One provision of the act allows service members to request

that the interest rate on pre-existing debts be restricted to 6 percent while they are on active duty. This includes credit card debt, mortgages, and the like. The financial institution must honor the request or go to court to show why active duty does not materially affect the service member's ability to pay.

Many U.S. military men and women in Afghanistan and Iraq relied on their credit union for financial assistance and advice. (Bigstock Photo)

Defense credit unions have been serving military personnel within the U.S. since 1928. In the 1960s, in the wake of investigations that showed American service members overseas were being preyed upon by high interest lenders, Congress authorized those credit unions to open branches overseas.

Many military men and women and their partners are young—some just out of high school—and often lack financial

skills. They are also easy prey for scams and predatory lenders who cluster around military bases "like bears on a trout stream," as one officer put it. A 1998 study of Navy personnel found that 43 percent had trouble paying monthly bills. Besides offering lower-cost services, the defense credit unions try to meet these challenges with financial counseling.

"At our credit union, for example, some 425 credit union members annually take advantage of our free in-house financial counseling services—including debt management, at no cost to the member or participating creditors. (Sixty percent of our debt management clientele is military.)," according to Jill Lisinski of ABNB Federal Credit Union, Virginia Beach, Virginia.

"A positive alternative to bankruptcy, debt management helps members resolve their credit card debt through credit union-brokered renegotiations with creditors, employing such steps as lowering the interest rate and/or monthly payment amount, waiving late fees while on the program, or accepting reduced payments. In return, the member agrees to commit to a 'cash-only' lifestyle for the length of the program, which ranges from six weeks to 60 months."[362]

Defense credit unions wishing to operate overseas are granted franchises to serve particular geographic areas. Navy Federal Credit Union is the most far-flung, with branches in some 14 countries, ranging from Bahrain in the Middle East to Cuba, Canada, Iceland, and Spain.

In addition, military personnel can use a network of ATMs and Point of Sale terminals at or near military bases around the globe (the Armed Forces Financial Network or AFFN) to transact business with their credit union or military bank. And finally, as the defense credit unions adopted on-line financial services in the 1990s and later, men and women serving at almost any location could access their accounts by phone or the Internet

[362] "Defense Credit Unions Help Military Families With Financial Counseling and Debt Management Services," Winter 2003-04, Military Money, InCharge Education Foundation, Orlando, Florida.

Chapter 66

Enron—A Credit Union Survives Sponsor Collapse

The tumult of 9/11 and the bursting of the dot-com bubble were not the only news stories of 2001. A series of corporate scandals revealed that the capitalist barrel had its rotten apples. Foremost among these was Enron, the Houston, Texas, energy trading giant, which imploded and went into bankruptcy December 2, 2001. Post-collapse investigations revealed fraud and corruption. The scandal led to the demise of Enron's accounting firm, Arthur Anderson, and passage of the Sarbanes-Oxley Act of 2002, which tightened accounting standards for publicly owned companies.

The Enron bankruptcy threw its 22,000 employees out of work, and the future of its $56 million credit union was cloudy as its members lined up outside its third floor office in Enron headquarters to withdraw their funds.

Fortunately, the credit union was not caught completely unprepared. Two years earlier, in 1999, its board reluctantly discussed what to do if the nearly unthinkable occurred—the failure of its sponsor. At the time, Enron was riding high and its collapse seemed about as likely as a meteorite's striking the credit union. But the board nonetheless discussed what to do in the event. So when this black swan flew into the office, management had a plan in place to deal with it. [363]

The idea was to let members, staff, and board know what was going on and that the credit union was separate from the company and financially sound. The key was communication —lots of it, face to face as much as possible, but also by telephone, letters, and the credit union's web site. "We . . . repeatedly told the story of how we were different and independent. Safe and sound," recalled Jack McAdoo, CEO of Enron Federal Credit Union at the time.[364]

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[363] "Black swan" is a term invented by financial writer Nassim Nicholas Taleb to describe improbable events that play a larger part in economic life than "the experts" like to think.

[364] Quoted in "What's Enron Got to Do With It," cugrow.com.

The credit union moved rapidly to change its name to StarTrust Federal Credit Union, expand its field of membership, and move to a new location away from the Enron building but close enough to be convenient to its members living in the area. The credit union lost some members, but then membership began to climb again. As of 2012, StarTrust had 5,568 members, more than $48 million in assets, 11 employees, and three branches in addition to its main office.

Former CEO McAdoo summed up the experience in this way: "We made it through the debacle because we planned . . . . None of us thought it would ever happen. We gave it a probability of near 0 of happening, but we had a plan. Guess what? It happened! . . . . Even though it seemed silly at the time, I'm sure glad we did it."[365]

Chapter 67

Credit Unions Set Legislative Goals

In a new decade marked by domestic and foreign turmoil, credit unions remained active on the Washington, D.C., scene. While the Credit Union Membership Access Act (CUMAA) had preserved the credit union movement, the bankers had managed to impose some new restrictions on credit union powers. In addition, NCUA under the D'Amours administration was continuing to try to impose social responsibility requirements.

To gain input and guidance on the direction lobbying efforts should take post-CUMAA, the CUNA Board voted in May, 2000, to create a "Credit Union Renaissance Commission" to develop a blueprint for the legislative and regulatory future.

The commission focused on the long-term future of the credit union movement, what member needs would be, and the future ability of credit unions to meet those needs.

It tackled three main areas of concern:

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[365] Ibid.

- field of membership;
- credit union powers and authorities; and
- regulation and insurance.

In its final report to the CUNA Board in June, 2001, the commission noted the increasingly rapid pace of economic change:

"Accelerated change in the overall business environment, including rapid technological change, increased competition, and emerging member expectations, requires credit unions to dramatically transform themselves or face the danger of becoming irrelevant to their members."[366]

The commission found that many credit unions considered state charters more attractive than federal and noted that since passage of CUMAA in 1998, the pace of charter conversions had picked up "and is likely to continue at this pace."[367]

The commission called for expanded powers to enable credit unions to meet the evolving needs of their members. And it proposed that credit unions be given access to secondary capital like the uninsured member shares corporates used to boost their capital. Such added capital could be used to provide a financial base for developing new products and services.

On field of membership, it called for credit unions to have the right to define their own fields of membership so that every consumer could have access to credit union services. Overlapping fields of membership should be permissible, the report stated.

In the area of regulation and insurance, the Renaissance

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[366] "Report to the CUNA Board," Chapter 1, CUNA Renaissance Commission, June, 2001, p. 1.

[367] In the early 1990s, in the wake of the private insurance crises, conversions were overwhelmingly toward federal charters. This trend reversed in 1997 in the wake of the court decisions that froze growth of federal credit unions through SEGs. In addition to conversions to state charters, from 1997 through 1999, 17 credit unions switched to thrift charters.

Commission argued that NCUA and its insurance fund were becoming too intrusive by, among other things, imposing "CRA-lite."

"(I)t is not the responsibility of regulatory authorities to define, direct or examine the social mission of credit unions. That is the responsibility of each credit union's board of directors."[368]

Regulators should focus on safety and soundness, the report stated. It called for providing a private share insurance alternative to federal share insurance.

NAFCU also weighed in on these issues. In a 2000 paper for the Federal Reserve Board, it stated that:

"Despite the growing record of success of our nation's credit unions throughout the 20th century, there are some troubling trends, of which the conversion from federal to state charter is NAFCU's paramount concern.

"Conversion from federal to state charter totaled 70 in 1997, 44 in 1998 and 32 in 1999. As of October 31, 2000 there had been 18 federal to state conversions this year. While these numbers might suggest that the conversion trend has peaked, this is hardly the case. There are another 32 federal to state conversions reportedly pending.

"In addition, the size of credit unions converting from federal to state charter, and therefore the total assets involved in such conversions, is on the increase; the average assets and median assets are dramatically increasing.

"NAFCU believes that conversion from federal to state charter is a symptom and not, in and of itself, a problem. The problem, of course, is reflected in the explanation people consistently give for initiating charter conversions.

"The most common and uniform explanation—yet clearly not the sole explanation—NAFCU receives involves more rigid field of membership policies and/or their application that exist at the federal level, not only with select employment groups, but particularly with community charters."

[368] Ibid., p.9.

"Other reasons for conversion that NAFCU has identified include:

- "The desire for regulatory flexibility that is deemed requisite to survive and to grow in the 21st Century.
- "The need to diversify membership and portfolio.
- "The elimination of unnecessary and needless regulations.
- "The need to innovate and enable credit unions to meet their future membership needs.
- "The ability to offer investment and insurance products that meet membership needs.
- "The offering of a more favorable business climate.
- "The need for a progressive and pro-business regulatory environment." [369]

Prompt Corrective Action (PCA) continued to be a concern to credit unions, particularly larger, fast-growing ones. Three academics who looked at the consequences of this aspect of CUMAA noted that while the capital provisions appeared to stimulate under-capitalized credit unions to increase their reserves more rapidly, PCA was having some untoward consequences:

"Most credit unions are low risk, due to restrictions on their activities embodied in cooperative principles and the common bond. However, the system of prompt corrective action . . . does not differentiate between high- and low-risk institutions. Consequently, low-risk credit unions may tend to hold excessive amounts of capital.[370]

"Because credit unions cannot issue equity, the current system leaves credit unions exposed to automatic regulatory

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[369] "2000 Credit Union Report to the Board of Governors of the Federal Reserve System, National Association of Federal Credit Unions," National Association of Federal Credit Unions.

[370] Such excess capital, for instance, might be more productively used to improve member service, offer better rates, or develop new products and services.

PCA intervention (and a Net Worth Restoration Plan) if there is an unexpected large growth in assets which outweighs any increase in net worth.

"This was evidenced in the early 2000s when investors switched from financial markets investment toward safe credit union deposits. The subsequent pressure on capital ratios (it was claimed) drove many credit unions to refuse deposits, reduce services, convert to Savings and Loans or Community Banks, or merge (with) other credit unions."[371]

The vast majority of credit unions were well capitalized. After 2000, under-capitalized credit unions were less than one percent of the total.

Chapter 68

Legislative Goals Difficult to Reach

Starting in 2001, in the wake of the Patriot Act, Congress began looking at ways to relieve some of the growing regulatory burden on the financial services industry. The credit union trade associations and regulators worked closely with key committees on Capitol Hill to make sure credit unions were included in this effort and that the federal charter remained competitive. Due to bank opposition, the process turned out to be a long and often frustrating one.

The three main aims of the movement were:

1. Raise the cap on business lending.

2. Allow credit unions to raise secondary capital in addition to retained earnings, similar to the membership shares that served as part of the capital of corporate credit unions.

3. Give members a greater voice in proposed conversions to thrift charters. (As will be noted in the following chapter, it was becoming easier for credit unions to change to mutual thrift charters and harder for members to block it.)

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[371] Goddard, John, Donal McKillop, and John O. S. Wilson, "Prompt Corrective Action and the Evolution of Capital to Asset Ratios: Evidence for U.S. Credit Unions," circa 2010, Financial Management Association International, p. 6.

One of the main legislative vehicles for this effort was the Credit Union Regulatory Improvement Act (CURIA), H.R. 3579, introduced in late 2003 by Representatives Edward R. Royce (R-California) and Paul Kanjorski (D-Pennsylvania). For a discussion of this and other legislative proposals and congressional actions, the reader can consult Appendix B of this book. By 2010, the end result, however, was passage of only a few minor items unrelated to the three goals mentioned above.

The reasons for this lack of success appeared to be banker opposition, the reluctance of Congress to reenter the maelstrom surrounding passage of CUMAA, and a perceived lack of strong grassroots support for the sought-for provisions. The fact was, topics like raising the business loan ceiling were of intense interest only to a minority of credit unions doing a substantial amount of such lending. The majority of credit unions were not greatly affected by the restrictions on business lending.

Credit unions and other creditors did win additional bankruptcy reforms in 2005 with passage of the Bankruptcy Abuse Prevention and Consumer Protection Act. The two national credit union associations took different paths in seeking the new law. CUNA remained part of a larger coalition of creditor groups, while NAFCU lobbied on its own.

Before passage of the act, personal bankruptcy filings jumped to record highs as consumers sought to get their cases heard before the law went into effect. Filings dropped to levels not seen since the late 1980s after its passage, but then began rising again.

Chapter 69

Conversion Blues

As previously mentioned, since the mid-1990s a trickle of credit unions had been converting to mutual thrift charters.[372]

[372] The term "mutual" indicates member ownership. The term "mutual thrift" covers a variety of institutions, including mutual savings associations

The usual reason given by the credit union managers and boards was the need for capital. "The thrift charter looks tempting to many credit unions because thrifts can raise capital more easily, and need not hold so much—5% of assets, as opposed to 7% for credit unions," reported the American Banker. [373]

NCUA and the organized movement were concerned that members were losing out in the process,

The Federal Credit Union Act gave NCUA power of approval over conversions to mutual thrift charters by federally insured credit unions. Until the mid-1990s, however, no federally insured credit union had ever done so, and NCUA had no rules in place to govern the conversion process. But in 1994, the board of Lusitania Federal Credit Union, New Jersey, a $52 million institution, sought NCUA's approval for converting to a mutual thrift, and the agency had no choice but to grant it.

On September 1, 1995, the credit union became Lusitania Savings Bank. The somewhat clumsy process involved creating a new, or "de novo," mutual thrift which then purchased the credit union's assets and liabilities. In response to problems NCUA perceived in how this was handled, it adopted a rule to better protect member interests in the conversion or merger of a credit union into a non-credit union institution.

(savings and loans) and mutual savings banks. While mutual thrifts are member-owned, member control is more theoretical than practical. Unlike credit union "one member, one vote" governance, federal mutual thrift members with more money on deposit ordinarily have more voting power. (Federal thrifts can, however, choose to imitate credit unions with one member, one vote.) When people join a thrift, they are usually asked to sign over their voting rights to management, and nearly all do so. Other differences: Credit unions are exempt from federal income tax and most state income taxes, whereas mutual thrifts are not. While credit union directors and committee members serve on an unpaid volunteer basis, mutual thrift board members can be compensated. The real significance of a switch to a mutual thrift charter is that it opens the door to a later conversion to a stockholder-owned thrift, where insiders have a much greater opportunity to profit personally.

[373] "Credit Union Conversion Guru Calls Trend Inevitable," Thompson Media reprint from American Banker, Community Banking, March, 2002.

The rule covered adequate disclosures to members, specified voting procedures, and set standards for NCUA approval or disapproval of a conversion. Most importantly, it required the affirmative vote of a majority of the credit union's members before a conversion could take place.

Not every credit union considering conversion was able to muster approval by a majority of its members, but five did so in 1998. However, proponents of conversions argued that NCUA had made the process too difficult—that it was acting as a "credit union jailer."

When Congress enacted the Credit Union Membership Access Act (CUMAA) in 1998, conversion proponents were able to slip in a provision removing NCUA's power of approval over conversions, although it did leave NCUA with authority to supervise member voting on conversions. The legislation lowered the bar for member approval to a majority of those casting votes, even if only a small percentage of members actually voted. Representative Paul Kanjorski (D-Pennsylvania), a credit union "hero" in helping push through CUMAA, recalled later that:

"The decision to (lower the bar on member approval of conversions) to zero . . . was made at 11:30 at night, when we were faced with the proposition that if H.R. 1151 hadn't passed, it would literally destroy the credit union movement . . . . And we all recognized that this (lowering of the bar) was a dangerous situation that was in the bill, and hoped in the future to make that correction and change that circumstance . . . .

"That was a special provision . . .based on, if I remember, Utah organizations that wanted to make these conversions. And many of us thought well, if that's Utah wanting to do that, that's their problem. But we didn't think it would be spreading across the country as it has since 1998."[374]

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[374] Statement made during the hearing on H.R. 3206, The Credit Union Charter Choice Act, before the Subcommittee on Financial Institutions of the Committee on Financial Services, U.S. House of Representatives, 109th Congress, Second Session, May 11, 2006, Serial No. 109–91.

In the aftermath of CUMAA, some credit unions that had failed to get approval for conversion from a majority of members tried again under the relaxed standard, and this time they succeeded. These included Citizens Community Federal Credit Union of Wisconsin, which converted after a vote by just 11 percent of its members.

The number of conversions remained relatively modest, however—three in 1999, another three in 2000, shooting up to eight in 2001. But then the number declined, totaling only eight over the next five years. (These figures include not only conversions but also mergers of credit unions with thrifts.) However, the asset size of credit unions seeking to convert increased.

Under CUMAA, a federally insured credit union proposing to convert to a mutual thrift needed to submit notice of its intent to convert to each of its eligible voting members 90, 60, and 30 days before the date of the member vote on the conversion.

Concerned that members were not getting adequate information, NCUA in February, 2004, amended its rules "to require a converting credit union to disclose additional information to its members to better educate them regarding the conversion." The rule required, among other things, that:

1. The vote on the conversion proposal must be by secret ballot and conducted by an independent entity.

2. The credit union must enclose with each written communication to its members concerning the conversion a discussion of how it would affect ownership and control and its effect on rates and services, the possibility that a subsequent conversion to a stock institution might allow executives of the institution to profit (e.g. by obtaining stock in excess of that available to individual members), and costs of the conversion.

3. A converting credit union must be careful to make certain that its member list is accurate and complete.

4. A converting credit union must be careful to conduct its special meeting concerning conversion in a manner that will

accommodate all members wishing to attend.

Proponents of conversions argued that the approval rule was arbitrary and restrictive and that NCUA was deliberately attempting to keep credit unions under its jurisdiction. Critics of conversions argued that NCUA was simply protecting the rights of members and that, too often, conversion was a maneuver on the part of credit union boards and management to enrich themselves.

This enrichment might take the form of pay for directors (allowed for thrifts but not credit unions) and higher pay for managers than they could expect in credit union work. One prominent conversion consultant in a 2002 article used such wealth enhancement as one of the arguments for conversion. "Bank directors typically earn between $2,500 to over $50,000 annually, in addition to travel and expense allowances, while credit union directors are typically uncompensated. . . . Bank CEOs typically receive much greater compensation than credit union CEOs, with the bank CEOs receiving from 20% to 57% more for institutions of similar assets size."[375]

But the biggest opportunities for gain lay in converting from a mutual thrift to a stock thrift—and most credit unions that converted to mutual thrifts later converted to stock thrifts.

This type of conversion gives the thrift an opportunity to offer stock to the public for purchase. The sale of stock transfers ownership of the thrift's accumulated earnings from the members to those who buy the stock.

Such a stock offering is called an Initial Public Offering, or IPO. When an IPO is made, mutual thrift members, directors, and management receive options to buy the stock at the IPO price, usually $10 per share.

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[375] Theriault, Alan D., "CEO & Directors: Salary Imbalance is Corrected by Converting to a Bank," Sept. 16, 2002, quoted in "Conversion of Insured Credit Unions to Mutual Savings Banks," National Credit Union Administration, Notice of proposed rulemaking with request for comments, June 27, 2006.

In many cases, however, the average member either is not interested in becoming a stockholder or cannot afford to purchase the stock.

"Converting financial institutions typically require depositors to pay up front and in full for the shares they request at the time they submit their subscription agreements or stock order forms. Those sums can easily be tens or hundreds of thousands of dollars — amounts that many depositors cannot afford on their own," as the U.S. Securities and Exchange Commission (SEC) puts it.[376]

In contrast, according to economist James A. Wilcox, "well-informed 'insiders' (i.e., managers and directors of converting thrifts) typically purchase a large fraction of the shares of stock that are offered in IPOs. Insiders also may effectively purchase additional amounts via their employee stock ownership plans (ESOPs)."[377]

As the conversion consultant quoted earlier put it in his article:

"For example, assuming a credit union with $50 million in capital converts to a stock bank with an IPO amount of $100 million, directors would share a $2 million grant of stock, and management would receive an equal grant. Each member of a five director board would get $400,000 in stock, vested over five years, at the IPO value."[378]

In the case of Citizens Community Federal Credit Union, after its conversion first to a mutual and then a stock thrift, its

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[376] "Mutual to Stock Conversions: Tips for Investors," On-line brochure, U.S. Securities and Exchange Commission, June 7, 2007.

[377] Wilcox, James A., "Credit Union Conversions to Banks: Facts, Incentives, Issues and Reforms," Filene Research Institute, Madison, Wisconsin, 2006, p. 47.

[378] Theriault, Alan D., "CEO & Directors: Salary Imbalance is Corrected by Converting to a Bank," Sept. 16, 2002, quoted in "Conversion of Insured Credit Unions to Mutual Savings Banks," National Credit Union Administration, Notice of proposed rulemaking with request for comments, June 27, 2006.

directors and managers wound up owning almost a third of the thrift.[379]

The price set in the initial public offering usually is lower than the value perceived by the market. This means that after the offering, there is a quick rise in the market price, called the "pop." This can provide an easy profit for directors, managers, and speculators who sell shares after the pop. The pop varies widely in range. For Citizens Community, it was nearly 24 percent.

Thrift initial stock offerings are an invitation to fraud by outsiders. Federal and state banking regulators try to prevent rampant speculation by outsiders by restricting the number of shares that any one depositor may acquire and prohibiting depositors from agreeing to transfer their shares to anyone else before the shares are issued. However, fraudsters often attempt to evade such restrictions.

"Although there are many variations of this type of scheme, in the typical case, the fraudster will identify and approach a depositor who has non-transferable subscription rights, offering to "loan" the depositor the money required to purchase the maximum number of shares . . . .In exchange for funding the purchase, the fraudster typically will require the depositor to either (1) transfer the conversion stock to an account that the fraudster controls or (2) sell the stock and give the fraudster a majority of the profits," the SEC states. [380]

"The fraudster will further persuade the depositor to keep secret their arrangement and to submit subscription documents or stock order forms that falsely (or misleadingly) represent to the bank or savings association that the depositor is the true purchaser of the stock, has not transferred his or her subscription rights to any person or entity, and has

[379] According to a Credit Union Journal Survey cited by James A. Wilcox in "Credit Union Conversions to Banks: Facts, Incentives, Issues and Reforms," Filene Research Institute, Madison, Wisconsin, 2006, p. 47.

[380] "Mutual to Stock Conversions: Tips for Investors," On-line brochure, U.S. Securities and Exchange Commission, June 7, 2007.

entered into no agreement regarding the sale or transfer of the stock."

For example, the SEC on May 16, 2007, charged a former Wall Street executive and three others in a scheme to defraud savings banks and their depositors in dozens of stock offerings. This was a civil action. Over a 10 year period the four generated some $12 million in illegal profits from bank stock fraudulently obtained in 65 public offerings, including eight issued by converted credit unions. The four agreed to an injunction to not engage in further such activities and paid several hundred thousand dollars as a gesture to "disgorge" their ill-gotten gains, plus fines.

In addition, the ringleader of the fraud, one Bert Fingerhut, a retired securities expert and prominent Aspen, Colorado, environmentalist and ski rescue team member, pleaded guilty to a criminal charge in New York State and agreed to cough up $11 million of his profits from the scheme. He was sentenced to two years in federal prison, but was freed on supervised release seven months early in 2009 for good behavior.[381]

The issue of NCUA's charter conversion rule came to a head in a dispute over the December 2004, conversion application of Community Credit Union, Plano, Texas, a suburb of Dallas. The $1.4 billion credit union was one of the largest in Texas and to that date the largest ever applying for conversion. Another billion-dollar-plus Plano credit union, OmniAmerican, quickly followed suit.

The Texas economy was booming at the time, and banks were making good profits. "Everybody wants to be a Texas bank," reported the Dallas Morning News. "Out-of-state banks are buying up in-state banks. In-state banks are merging with one another. Even some local credit unions are fighting to convert their charters to banks. All are signs of a red-hot Texas banking scene, analysts say."[382]

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[381] "Bert Fingerhut quietly seeks return to old Aspen life," Aspen Times, July 12, 2010.

[382] "Banks are eager to try on Texas boots," 2005 Dallas Morning News article carried on StartABank.com.

The Community Credit Union conversion had been approved by the Texas Credit Union Department, the U.S. Treasury Department's Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC), which would insure the thrift.

But the NCUA vacated the member vote. Among other things, the credit union had mailed out required member information sheets that were folded so that the member would see NCUA's cautionary information statement only after seeing the credit union's rebuttal arguments. The NCUA also found fault with OmniAmerican's voting procedures.

The credit unions hired lobbyists to enlist support in Congress for their conversion effort.[383] A number of Texas lawmakers and Representative Barney Frank (D-Massachusetts), the ranking Democrat on the House Financial Services Committee, wrote letters to NCUA expressing their concern.

In addition, Community Credit Union filed suit in the United States District Court for the Eastern District of Texas against the NCUA, its chairperson, and its regional director in Austin. OmniAmerican joined the suit as a friend of the court. The judge in the case ruled against the NCUA. The agency then reached a settlement with the credit unions that cleared the way for their conversions to mutual thrifts. They later converted to stock thrifts.

As a result of the dispute, Representative Patrick T. McHenry (R-North Carolina) introduced H.R. 3206, the Credit Union Charter Choice Act, on July 12, 2005. This bill sought to limit the kinds of information NCUA could require that converting credit unions provide to their members.

The proposal would have prevented NCUA from requiring a credit union to provide information about future governance of the institution. And it would have restricted NCUA from requiring disclosures that were "speculative," "inaccurate with respect to a proposed conversion," or that would "distort the

[383] "Converting CUs Retained High-Priced Lobbyist," Credit Union Journal, March 27, 2006.

impact of the conversion." In particular, the bill would have eliminated any reference to profits for managers and board members from a later conversion to stock form.

The bill also would have denied NCUA any further review or approval authority over the conversion process absent fraud or reckless disregard for the voting process that affected the vote outcome.

The House Financial Institutions Subcommittee held a hearing on the bill on May 11, 2005. The banking community vigorously supported the bill, but NCUA, CUNA, and NAFCU argued against it. No further action was taken, and the conversion controversy subsided.

In an interesting situation that wound up protecting member interests, Nationwide Federal Credit Union agreed in 2006 to be acquired by Nationwide Bank. The credit union served employees and retirees, and their families, of the Nationwide Financial Group, whose principal member is Nationwide Mutual Insurance Company. The bank was a thrift owned by the Group. In the merger, the equity of members in the credit union, some $79 million in reserves built up through the years, was distributed to members.

Chapter 70

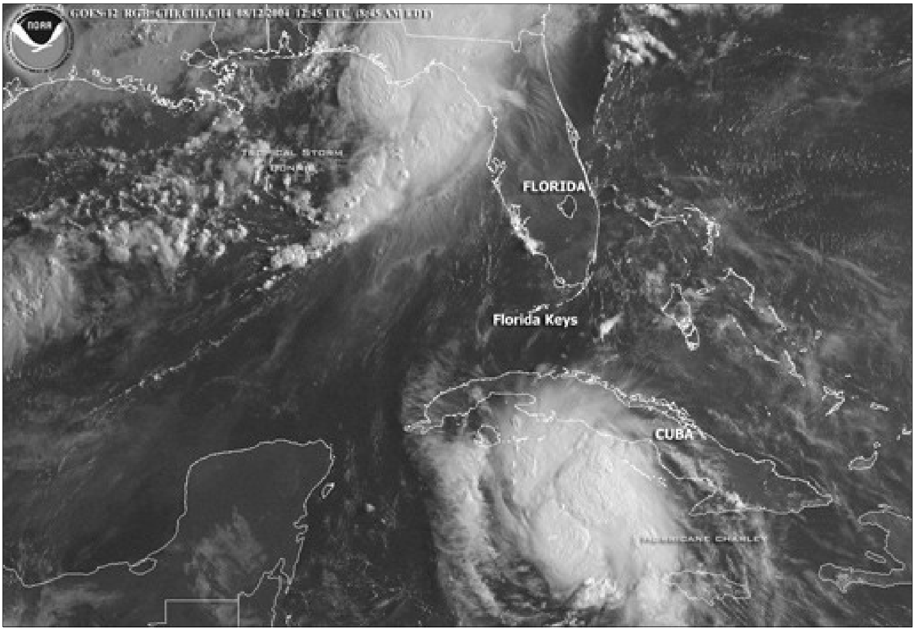
Hurricane!

Whether due to global warming or the roll of the weather dice, the U.S. southern coast and its credit unions underwent an onslaught of hurricane destruction in mid-decade. The disasters were aggravated by the shift of U.S. population over decades to the South, especially to coastal areas vulnerable to storms.

Florida was target of a historic spate of storms in the late summer of 2004. They cost more than $40 billion in property damage and took 127 lives in the state.

The first storm was just a taste of what was to come. Tropical Storm Bonnie with 45-mile-per-hour winds and heavy rain moved inland from the Gulf just south of Apalachicola in

the curve where the Florida Panhandle joins the state's west coast. It spawned tornadoes as it moved up through the Mid-Atlantic states.



Tropical Storm Bonnie (top) sweeps over Florida as Hurricane Charlie approaches via Cuba. (American Geophysical Union Photo)

A day later, on August 13, Hurricane Charley made landfall from the Gulf near Punta Gorda, Florida. The fast-moving, compact storm's high winds caused heavy damage.[384] Charley swept up through Central Florida to Daytona Beach and out to sea, to make landfall again in South Carolina the following day. Credit unions were not substantially harmed by

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[384] A number of people on the coast, as the hurricane approached their communities, took refuge in the little inland town of Arcadia (where the author attended 8th through 10th grade many years ago), only to have the hurricane nearly destroy the town, taking the roof off a shelter where several hundred people had sought refuge. "The storm blew houses off their foundations, snapped trees and power lines and destroyed the town's water tower. Mobile home parks were flattened," reported the Sarasota Herald-Tribune on August 14, 2004.

the storm, but many of their employees and volunteers had their homes severely damaged. The Florida Credit Union League's foundation launched a Hurricane Charley Relief and Recovery Fund to provide disaster aid to the state's credit union "family." All too soon, it had to drop the "Charley" from the name of the fund as more storms swept through the state.

Some three weeks after Charley made landfall, on September 5, Hurricane Frances moved ashore from the Atlantic between Fort Pierce and West Palm Beach. It was a large, slow-moving storm that swept up and across the Florida peninsula, moving out into the Gulf and then hitting the Florida Panhandle and Alabama coast. It dumped some 15 inches of rain in some locations in the southeast U.S. and triggered a record 123 tornadoes.

Ivan made landfall in southern Alabama on September 16, weakened to a tropical storm, then looped out over the Atlantic's Gulf Stream, strengthened, and wandered southward and westward to cross southern Florida on September 21 into the Gulf of Mexico. As a tropical storm, it eventually hit Louisiana and died out over Texas.

The chain of hurricanes did some damage to credit unions but one of the biggest problems was disruption of service due to storm shutdowns and power and water outages. Once credit unions were reopened, employees had to struggle to get to work through streets littered with storm debris.

Some credit unions were well prepared for the eventualities. One example was Pen Air Federal Credit Union, Pensacola, Florida, as reported in NAFCU's online newsletter:

"In the days before Florida was hit by hurricane Ivan, Pen Air FCU took steps to ensure it would be able to provide service to its members. Its disaster recovery team met regularly, supplies were delivered to all offices and extra cash was ordered—as was extra fuel for generators. Pen Air's president/CEO, John Davis, two board members and their

families stayed at the credit union's remote hot site during the storm and for eight days afterward.[385]

"As a result of its preparation, the credit union was able to provide drive-through service (including ATM service) at three offices immediately after the hurricane struck. Nearly all of the credit union's offices sustained damages of varying types, including leaking roofs. But, within a week, 12 of the credit union's 13 offices were opened and 23 of its 30 ATMs were back on line. (More than $3 million were withdrawn from the ATMs.)

"Thanks to its disaster recovery planning and execution, Pen Air FCU was one of the few Florida-based financial institutions that was nearly 100 percent operational within the first week after Ivan hit.

"Pen Air FCU worked with Wright-Patt CU and River Valley CU, two Ohio cooperatives, to serve hot meals to those in need. Food donations came from sponsors such as McDonalds and Pepsi Corp.

"In addition, to help members with repairs, the credit union offered disaster recovery loans (in amounts up to $10,000 at an APR of 6.5 percent for 60 month terms). And it waived many fees and made special arrangements for members who were about to become past due on existing loans.

"John A. Davis, the credit union's president, had high praise for his staff. In a written statement, he noted that 'nothing would be possible without staff. When I saw everyone waiting for their assignments, I knew everything would work out.'"

On September 25, Atlantic Hurricane Jeanne made landfall in Florida near where Frances had struck three weeks earlier. Heavy rains, on top of previous hurricanes, caused extensive flooding in the southeastern U.S.

The League sent out a fresh appeal for funds. "The past six weeks has been a trying one for all Floridians. Our state has

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[385] A "hot site" is a backup site equipped to take over operations of a business in the case of a disaster affecting the main business location.

suffered the distinction of being the first state to experience four major hurricanes in one season since 1886. This unprecedented phenomenon has caused a great deal of personal loss for thousands of our fellow Floridians. Included in that total are hundreds of credit union volunteers and employees," League President Guy Hood said. “Many are at their wit’s end.”[386]

Chapter 71

Katrina

URGENT—WEATHER MESSAGE

NATIONAL WEATHER SERVICE NEW ORLEANS LA

1011 A.M. CDT SUN AUG 28 2005

...DEVASTATING DAMAGE EXPECTED....HURRICANE KATRINA...A MOST POWERFUL HURRICANE WITH UNPRECEDENTED STRENGTH...RIVALING THE IN-TENSITY OF HURRICANE CAMILLE OF 1969.

MOST OF THE AREA WILL BE UNINHABITABLE FOR WEEKS...PERHAPS LONGER. AT LEAST ONE HALF OF WELL-CONSTRUCTED HOMES WILL HAVE ROOF AND WALL FAILURE. ALL GABLED ROOFS WILL FAIL ...LEAVING THOSE HOMES SEVERELY DAMAGED OR DESTROYED.

THE MAJORITY OF INDUSTRIAL BUILDINGS WILL BECOME NON FUNCTIONAL. PARTIAL TO COMPLETE WALL AND ROOF FAILURE IS EXPECTED. ALL WOOD FRAMED LOW RISING APARTMENT BUILDINGS WILL BE DESTROYED. CONCRETE BLOCK LOW RISE APARTMENTS WILL SUSTAIN MAJOR DAMAGE ...INCLUDING SOME WALL AND ROOF FAILURE.

HIGH RISE OFFICE AND APARTMENT BUILDINGS WILL SWAY DANGEROUSLY...A FEW TO THE POINT OF TOTAL COLLAPSE. ALL WINDOWS WILL BLOW OUT.

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[386] “We need help. Fla. league appeals for more funds,” Credit Union Newswatch, October 1, 2004.

AIRBORNE DEBRIS WILL BE WIDESPREAD...AND MAY INCLUDE HEAVY ITEMS SUCH AS HOUSEHOLD APPLIANCES AND EVEN LIGHT VEHICLES. SPORT UTILITY VEHICLES AND LIGHT TRUCKS WILL BE MOVED. THE BLOWN DEBRIS WILL CREATE ADDITIONAL DESTRUCTION. PERSONS...PETS...AND LIVESTOCK EXPOSED TO THE WINDS WILL FACE CERTAIN DEATH IF STRUCK.

POWER OUTAGES WILL LAST FOR WEEKS...AS MOST POWER POLES WILL BE DOWN AND TRANSFORMERS DESTROYED. WATER SHORTAGES WILL MAKE HUMAN SUFFERING INCREDIBLE BY MODERN STANDARDS.

THE VAST MAJORITY OF NATIVE TREES WILL BE SNAPPED OR UPROOTED. ONLY THE HEARTIEST WILL REMAIN STANDING...BUT BE TOTALLY DEFOLIATED. FEW CROPS WILL REMAIN. LIVESTOCK LEFT EXPOSED TO THE WINDS WILL BE KILLED.

AN INLAND HURRICANE WIND WARNING IS ISSUED WHEN SUSTAINED WINDS NEAR HURRICANE FORCE ...OR FREQUENT GUSTS AT OR ABOVE HURRICANE FORCE...ARE CERTAIN WITHIN THE NEXT 12 TO 24 HOURS.

ONCE TROPICAL STORM AND HURRICANE FORCE WINDS ONSET...DO NOT VENTURE OUTSIDE!

Hurricane Katrina was the costliest natural disaster in U.S. history. The storm center moved ashore near the Louisiana and Mississippi border around 9:45 a.m. on August 29. It remained a vigorous storm as it moved inland and up through the Mississippi River valley into the Midwest. It spawned dozens of tornadoes.

“The storm surge ravaged coastal Mississippi, and several levee breaches occurred in and around New Orleans. The levee breaches and over-topping resulted in floodwaters of 15 to 20 feet covering about 80 percent of the city. The catastrophic damage and loss of life inflicted by this hurricane is staggering, with an estimated 1,353 direct fatalities and 275,000 homes damaged or destroyed,” reported the U.S. Department of Commerce.

“According to the American Insurance Services Group, Katrina caused an estimated $40.6 billion in insured losses (as of June 2006). The National Hurricane Center (NHC) typically doubles the estimated insured losses for an estimate of total damage losses in the U.S., giving an estimated total $81.2 billion in damage. Total economic losses could be greater than $100 billion. These impacts make Katrina the costliest hurricane in U.S. history and one of the five deadliest hurricanes to ever strike the U.S.”[387]

A Coast Guard rescuer gazes over the flooded streets of New Orleans after Hurricane Katrina. (Defense Department Photo)

Whole coastal communities vanished. Fortunately, some 80 percent of the population were evacuated to safer inland communities like Shreveport, Louisiana. In the aftermath of the storm, there was a great deal of finger-pointing and blaming, especially in the case of New Orleans, over whether

[387] “Service Assessment, Hurricane Katrina, August 23-31, 2005,” Department of Commerce, National Oceanic and Atmospheric Administration, National Weather Service, Silver Springs, Maryland.

the evacuation could have been carried out more successfully. And there was uproar over the inadequacies of government response at all levels.

The economic impact was immense. "Tens of thousands of jobs were lost due to severely damaged or destroyed businesses and supporting infrastructure. Major highways in and around New Orleans were damaged or destroyed, disrupting commerce. Katrina also affected the oil and gas industry by damaging platforms and shutting down refineries, and interrupted operations at two major U.S. ports in Louisiana," the Department of Commerce said.[388]

In the wake of the storm, large areas in coastal Mississippi, Alabama, and Louisiana were without power and communications. Credit union members and bank customers could not withdraw money or cash checks. Debit and credit card networks were down and an unknown number of ATMs were out of service.

The storm damaged, destroyed, or isolated a number of financial institutions. Flood waters cut off the New Orleans branch of the Federal Reserve Bank of Atlanta, which normally supplied both check and cash services to southern Louisiana and the nearby Gulf Coast.

Such effects, however, were mostly short term, the Congressional Research Service found in a post-Katrina analysis of the effects of the storm on the financial system. In many cases, fallback procedures were in place. For example, the Atlanta Fed instituted armored car deliveries of currency to operating bank locations, moved check clearing operations out of the affected area, and maintained the discount window to assist all depositories in meeting their needs for liquidity, among other actions.

One hundred and thirty-nine credit unions were in Katrina's path. By September 7, in briefings for Congress, NCUA reported that most of the affected credit unions, representing 90 percent of the group's assets and membership, were fully or partly operational. Louisiana's credit unions were

[388] Ibid.

hit hardest, with more than 50 in New Orleans flooded, according to Charles Elliott, president and CEO of the Mississippi Credit Union League in testimony on behalf of CUNA before Congress.[389]

However, thanks to their disaster preparedness, NCUA support, and help from the credit union movement, all 139 credit unions were operating in some fashion within three weeks after the storm.

"Many protective protocols put in place following the terrorist attacks of 9/11 and the hurricanes of 2004 appear to have proved their worth," the Congressional Research Service reported.

"Those protocols, which were required of all but the smallest depository institutions, included maintaining critical personnel and data storage (with at least daily backups) at sites at least 20 miles distant from (the financial institution's) headquarters. Apparently, in almost every case, backing up data has worked despite loss of electricity."[390]

NCUA issued a temporary ruling that permitted federal credit unions to provide assistance to other credit unions and non-members in the areas affected by the hurricane under certain conditions. They could provide emergency services like check cashing and ATM access to meet short-term emergency needs under their authority to engage in charitable activities.

The more than one million people who fled Katrina posed challenges to credit unions in the less affected areas. "While our members in the greater Baton Rouge area were not impacted to any degree resembling those further south . . . many (members) are providing temporary, and in some cases permanent, housing for family and friends," testified CEO Ken

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[389] Elliot, Charles, Written Testimony of President and CEO of the Mississippi Credit Union Association on Behalf of the Credit Union National Association on "Hurricane Katrina: The Financial Institution Response," before the House Financial Services Institutions Subcommittee, September 14, 2005.

[390] Jackson, William D. and Barbara L. Miles, "Katrina's Wake: Restoring Financial Services," Congressional Research Service Report to Congress, September 15, 2005, p. 2.

Bordelon of E Federal Credit Union, Baton Rouge, to Congress on behalf of NAFCU.[391]

"The need for cash and basic necessities has tripled in a matter of days. Add to that the increased fuel and energy costs, and (people's) finances are stretched thin.

"Institutions have been taking key steps to make sure that they have the cash available to meet their needs. We have experienced excellent cooperation from the Federal Reserve, our Corporate Credit Union System and our depository banking partners in this regard," Bordelon told lawmakers.

He noted that women evacuees often had checkbooks with them, while men did not.

"Not all members brought their identification with them when they evacuated—this makes check cashing extremely difficult and will make re-issuance of formal documents also more difficult. Members wanting to set up new accounts are having trouble due to the Patriot Act requirements."

"Many credit unions are waiving interest and/or principal payments on loans; waiving fees, such as for ATMs, overdrafts, etc.; serving nonmembers from the affected areas as permitted by the NCUA; facilitating the granting of credit by raising loan limits or otherwise easing repayment terms; and using ways other than documents to verify the identity of members," Mississippi's Elliott told Congress.

The Credit Union Service Corporation (CUSC) shared service center network to which many Gulf Coast credit unions belong, although disrupted in some cases, was a "godsend" in serving people displaced by the storm, Bordelon said.

For example, Jefferson Parish's website told parish employees that, "Please be advised that those evacuated Jefferson Parish employees who are members of the Employee Credit Union and are currently outside of Jefferson may utilize

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[391] Bordelon, Ken, "Hurricane Katrina: The Financial Institutions' Response," testimony before the Subcommittee on Financial Institutions and Consumer Credit United States House of Representatives, September 14, 2005.

any credit union service center in the United States for cash needs."[392].

NCUA also reported to Congress on the impressive mobilization of the credit union system within and outside the affected area.

"Cooperation among credit union leagues and trade organizations, corporate credit unions, service providers, and the state and federal regulatory authority will result in providing member service in this area as soon as feasible," the NCUA said.[393]

For example, Campus Federal Credit Union, Baton Rouge, provided space to the University of New Orleans Federal Credit Union and the New Orleans Fireman's Federal Credit Union, according to E Federal Credit Union CEO Bordelon.

Mississippi League's Charles Elliott, in congressional testimony on behalf of CUNA, provided other examples. "Staff from Merrimack Federal Credit Union of Massachusetts made a 3-day drive to Mississippi to deliver a recreational vehicle that was immediately put to use for staff housing. Patricia English with the North Carolina Credit Union League drove a mobile branch, which was donated by Carolina Telco Federal Credit Union, to Mississippi to be used by a credit union that lost their building in the storm."[394]

Less than a month after Katrina devastated much of the Gulf Coast, Hurricane Rita roared ashore at the Louisiana-Texas border and inflicted further damage, including widespread power, water, and gasoline shortages. But within a week, NCUA reported that "The fifty federally insured credit unions with assets totaling $1.9 billion that were temporarily

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[392] "Jefferson Parish Employees Can Utilize Credit Unions Outside of Jefferson Parish," Jefferson Parish News Release, September 7, 2005.

[393] "NCUA Reports to Congress on Hurricane Katrina," NCUA News Release, September 7, 2005.

[394] Elliott, Charles, written testimony on behalf of the Credit Union National Association, "Hurricane Katrina: The Financial Institution Response, before the House Financial Services Institutions Subcommittee, September 14, 2005.

closed due to Hurricane Rita are all now reporting operational status in Louisiana and Texas. Even though some credit unions may be operating from back-up sites, members should have access to their funds."[395]

Rita further demonstrated the value of shared branching. The network of shared branches operated by the Credit Union Service Corporation (CUSC) saw a jump in membership during the storm season. "We have noticed a spike in growth of participating credit unions in the Beaumont (Texas) area and other regions in hurricane alley," noted Carroll Beach, President/CEO of CUSC. "Many credit unions realized the importance of shared branching in disaster recovery planning, especially in those areas that are prone to Mother Nature's fury. These credit unions have decided that cooperating with each other is the best way to always be able to offer members access to their accounts at convenient locations all over the country."[396]

In late October, 2005, Hurricane Wilma caused some damage to credit unions in South Florida, but they were soon back in operation. CUNA Mutual, the chief insurer for credit unions, paid more than $28 million to cover losses from Katrina, Rita, and Wilma.

Faced with an avalanche of needs and credit unions eager to help, CUNA and the hardest hit leagues created a program called RESCU (Relief Effort and Support of Credit Unions) to coordinate the movement's efforts to aid credit unions in the hurricane-affected areas.[397]

Thousands of credit unions and their leagues chipped in equipment, supplies, space, funds, and staff time and travel to help their beleaguered fellow cooperatives.[398]

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[395] "All Hurricane Rita Affected Credit Unions Operational," NCUA News Release, September 30, 2005.

[396] "Beaumont Credit Union Realizes Value of Shared Branching," CUSC News Release, February 23, 2006.

[397] Ibid.

[398] "Movement rallied for Katrina victims: Last of a series," CUNA News Now, September 3, 2010.

Some $3.6 million was collected and distributed to provide relief for credit union employees and volunteers hit hard by the storms. It was the largest disaster fund-raising effort in U.S. credit union history and led to the National Credit Union Foundation's establishing a permanent on-line disaster relief platform called CU Aid that continues to raise relief funds after disasters like the 2010 Haiti earthquake.[399]

In the immediate aftermath of Katrina, Chip Filson, of Callahan and Associates, painted a bleak picture in assessing the effects of the storm. Looking at credit union losses in loans on autos destroyed or driven away, on mortgaged homes unprotected by flood insurance, and unsecured loans defaulted because of job losses, he predicted that the cost to the National Credit Union Share Insurance Fund (NCUSIF) might run between $100 million and $2 billion. The prophecy turned out to be wildly inaccurate, he confessed in looking back five years later.

"Just four months (after Katrina) the NCUSIF reported a positive net income for calendar 2005 of more than $74 million (up from $47 million in 2004), (and) a loss provision of only $20 million," he noted.[400]

He attributed this result to two factors—the assistance given by the credit union movement and the self-confidence of the credit unions affected by Katrina. "There is a tremendous regenerative power in the cooperative model," he wrote.[401]

While credit unions made an impressive comeback from the ravages of Katrina and other storms, a longer-range question was the viability of the stormed-ravaged areas. The New Orleans area, for instance, had not yet regained its former population five years after Katrina.

However, as government recovery aid poured in, there was a burst of entrepreneurial effort that helped the area's

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[399] Ibid.

[400] Filson, Chip, "A Lesson From Katrina: The Disaster that *Didn't* Happen," creditunions.com, August 8, 2010.

[401] Ibid.

economy. Credit unions undoubtedly contributed to this resurgence through their small business lending.

HOPE Community CU and Enterprise Corporation of the Delta, both in Jackson, Mississippi, tested innovative solutions to the region's post-Katrina housing crisis. (ECD/HOPE-Credit Union Magazine Photo)

Two of the leaders in aiding recovery were ASI Federal Credit Union and Hope Federal Credit Union, both low-income credit unions that were among the handful of financial institutions in the New Orleans area that acted as conduits for aid from the state, charitable organizations, and corporate donors. They distributed millions of dollars in assistance to small businesses and homeowners, in addition to their usual services to their members. Other credit unions, like Campus Federal Credit Union, Baton Rouge, Louisiana, and Navigator Credit Union, Pascagoula, made numerous small business loans to their members to help them recover in the wake of the storms.[402]

Chapter 72

The Great Recession

By 2006, an economic weather disturbance was gathering strength and would reach hurricane force by late 2007. Credit unions for the most part would withstand the events of this period, but the "Great Recession," as it was quickly dubbed, would shake the corporate credit union system and lead to its restructuring by NCUA.

Economists and historians will long debate the origins of the Great Recession. Economist Martin Feldstein listed six factors that in his view helped engender it.[403] The comments following each bullet point, however, are this author's summary.

- **Excessively low interest rates**. After the dot-com bubble of the late 1990s burst, the Federal Reserve kept interest rates low to encourage a "soft landing" for the economy. This helped accelerate the housing boom that had started in the 1990s, which in turn became the bubble whose bursting was the immediate cause of the panic of 2008.

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[402] The credit unions cited were featured in post-Katrina articles in Credit Union Magazine.

[403] Cited in *The Meltdown Years: The Unfolding of the Global Economic Crisis*, Wolfgang Münchau, McGraw Hill, 2010.

- **Bad financial regulation.** The free market ideology that pervaded government led to a relaxation of oversight, on the theory that bad practices would be punished by the marketplace and businesses in their own interest would regulate themselves.

- **Bad housing policies.** By the 1990s, the traditional market of credit-worthy borrowers taking out 30-year, fixed-rate mortgages was largely saturated. In 1995, some 64 percent of U.S. households owned their own home. With encouragement from the government, many lenders were increasingly focusing on the "subprime" market—borrowers who in another era would have had difficulty getting a home loan. In 1999, Fannie Mae, one of the principal buyers of mortgages from financial institutions, eased its credit requirements to increase home ownership among low-income consumers.

- **Failure by rating agencies.** The agencies that rated the creditworthiness of collateralized debt obligations (CDOs) are widely said to have become increasingly lax in their evaluations out of a desire to please the clients that needed the ratings to sell the securities.

- **Bad risk management.** The financial market was overconfident in its ability to manage risk. By converting borrower debt into securities and selling them to others, an institution could protect itself against risk, but the risk did not disappear—it became diffused throughout the system. Since the financial system was now interconnected worldwide, risks offloaded from the U.S. could be assumed by Germans or Japanese or Norwegians. The risks were also spread by the use of "credit default swaps," insurance in effect, to protect bond and CDO purchasers against defaults. Again, while this presumably protected buyers of these obligations against risk, the risk was simply placed elsewhere, with the insurers. With this "out of sight, out of mind" approach, nobody understood the total systemic risk that was building.

- **Excessive debt.** With the increasing reliance of all sectors of the economy on debt rather than savings, the

economy became more and more vulnerable to economic shocks as savings dwindled and businesses and households became more highly dependent on borrowing, which froze up as a result of the housing crash.

One might add to this list the get-rich-quick allure of the financial sector as opposed to traditional industries. The highly talented were attracted to Wall Street rather than Main Street enterprises. The financial industry's share of the American stock market climbed from 5.2% in 1980 to 23.5% in 2007. Instead of producing a tangible product, or being content with providing basic financial services like loans, the denizens of the financial sector became enamored with speculation and creating and selling exotic financial instruments that few understood but which promised big commissions.[404]

But none of these factors would have created the bubble without the faith of consumers (and media's so-called market experts) that housing prices could only rise. After all, they'd been rising for a generation. The idea was that the population was increasing and therefore there would always be a demand for more land and housing. (The author's late father-in-law used to say, "They'll never make more land.")

In addition, sheer villainy and greed played a role. Some mortgage hustlers preyed on the most vulnerable and least financially sophisticated families, many of them Hispanic and black. Some buyers sought to get rich by flipping houses. The bubble was becoming increasingly speculative by 2003 and 2004 as house prices in "hot" markets like Florida, California, Arizona, and Nevada rose some 20 percent annually.

Price appreciation of homes began slowing in 2004. Low-quality home lending peaked in 2005 and 2006. Then, as the housing bubble began to deflate, the debt problems hidden by price appreciation began to appear. Mortgage loan

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[404] This trend was noted in 1984 by Nobel laureate economist James Tobin, as cited in the article "Fixing Finance," January 22, 2009, The Economist. Tobin said, in a lecture, "I (suspect) we are throwing more and more of our resources, including the cream of our youth, into financial activities remote from the production of goods and services, into activities that generate high private rewards disproportionate to their social productivity."

delinquencies increased, especially among the latest subprime borrowers, who could not get out from under by selling or refinancing their homes.

One of the first signs of trouble was the announcement by the British banking group HSBC on February 7, 2007, of huge losses at its U.S. mortgage arm, Household Finance, due to subprime mortgages. In April, New Century Financial, a leading California subprime lender, filed for bankruptcy. In June, 2007, the investment bank Bear Stearns bailed out two of its hedge funds that had focused on subprime mortgages, to the tune of $1.6 billion. (Nine months later, Bear Stearns itself would be near collapse and would be merged with JP Morgan Chase, with Uncle Sam holding the shotgun.) American Home, one of the largest residential mortgage lenders in the country, filed for bankruptcy in August, 2007.

At this time, demand for credit union mortgage loans remained high, and they accounted for more than half of all credit union lending. Nearly 70 percent of U.S. credit unions—mostly larger ones—offered mortgage loans. The majority of credit union loans outstanding, 61 percent, were traditional, fixed rate mortgages that did not expose homeowners to interest hikes.

Credit unions were originating about 2 percent of the nation's mortgages, and of that 2 percent, some 30.4 percent were resold into the secondary market through government-sponsored agencies like Fannie Mae, the lowest percentage since 2000. Mortgage loans retained in credit union loan portfolios comprised about 9 percent of the outstanding mortgage loans held by depository institutions.

Some credit unions with NCUA approval had ventured into subprime lending, with the goal of opening up home ownership to persons with fewer resources. But there is little evidence that they engaged in bottom-feeding or deceptive sales practices, and for the most part they avoided the riskier types of subprime loans.

Largest CU Mortgage Lenders 2007

(HMDA Data)

	Lending Institution	All Originations	
		No.	$Dollars
1	Navy FCU	37,707	$5,883,304
2	Pentagon FCU	13,910	$2,332,033
3	State Employees' CU	11,457	$1,584,144
4	Boeing Employees' CU	4,581	$972,172
5	Kinecta FCU	1,776	$951,058
6	Desert Schools FCU	6,964	$782,286
7	Golden 1 CU	6,251	$657,682
8	Suncoast Schools FCU	3,927	$493,972
9	America First CU	4,670	$472,129
10	San Diego County CU	2,126	$441,768

In addition, as NCUA Chairman Joann M. Johnson told Congress in March, 2007, "the Federal Credit Union Act prohibits prepayment penalties and establishes a statutory limit for interest rates not to exceed 18%. Because of these statutory provisions, the regulatory environment for federal credit unions is not conducive to some of the features that make the cost of underwriting these loans more tenable to other types of institutions. For example, some institutions effectively lock subprime borrowers into upward payment adjustments and higher interest rates by charging prepayment penalties if the borrower wishes to refinance the loan."

As a result, NCUA reported, though in 2007 "federally insured credit unions also experienced a slight increase in

home mortgage delinquencies, which reflects the housing market in general . . . the increase in delinquencies was well below the national average indicating credit unions avoided exotic mortgages and followed more prudent, consumer oriented lending practices." [405]

The banking contagion spread from Wall Street to Main Street, the corporate credit union system, and credit unions around the nation. (Bigstock Photo)

However, as the economic distress continued to intensify, credit unions would find themselves affected in a number of ways.

Significantly, holders of collateralized mortgage obligations (CMOs) and collateralized debt obligations (CDOs) now had a yardstick other than the rating agencies to measure the vulnerability of their assets to rising delinquencies. This was the new ABX index, a complicated instrument that measured

[405] 2007 NCUA Annual Report, p. 12.

the market's perception of risk concerning a "basket" of securities. As subprime delinquencies rose in 2007, the ABX index plunged, calling into question the value of all bonds based on subprime mortgages.

Suddenly, institutions around the world whose investment portfolios were stuffed with subprime mortgage-backed securities found the value of these holdings falling—wrecking their balance sheets. They couldn't sell them because nobody could tell what the "true value" of these securities might be, since nobody knew what the ultimate default rate on subprime mortgages might be. And as the housing market weakened further, with defaults on traditional mortgages rising, securities backed by those standard mortgages also began to look suspect.

Because mortgage-backed obligations were held by institutional investors throughout the United States, Europe, and Asia, the credit-worthiness of many of the world's great financial institutions came into question. Banks were afraid to lend to each other or even the healthiest corporations.

By 2008, the situation had blossomed into a panic—and the credit systems in much of the world seized up. You could have a flawless credit record, but everyone was afraid to lend to you. "The subprime butterfly had flapped its wings and triggered a global hurricane," notes Niall Ferguson.[406] And the hurricane was about to blow the roof off the corporate credit union system.

U.S. institutions holding mortgage-backed securities included some of the largest corporate credit unions, which had increasingly sought the higher returns promised by mortgage-backed bonds.

"The troubled subprime mortgage market had an impact on some corporate credit unions in 2007," NCUA noted in its annual report for the year.

"While corporates, by regulation, only invest in the highly

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[406] Ferguson, Niall, *The Ascent of Money: A Financial History of the World*, Penguin Books, 2008, p. 274.

rated securities, even high-quality performing securities are experiencing market effects. As 2007 came to a close, the dislocation of the mortgage market made it difficult to value mortgage-related securities. (NCUA's Office of Corporate Credit Unions) took a proactive approach in those corporate credit unions with the highest concentrations of these securities by working closely with their staffs to ensure a reasonable and consistent approach is utilized in valuing the portfolios."[407] However, neither the corporates nor NCUA realized the depth of the problem.

As 2008 progressed, the full extent of the economic difficulties became clearer. Despite a series of Fed interest rate cuts, the stock market sank rapidly from its October, 2007, high of 14,165 as the nation and much of the world slid into the worst recession since the Great Depression of the 1930s.

To cover these economic events in any depth would require another book. So we will not go into the efforts by the Bush Administration and Congress to stave off a full-blown depression—the Fed's pumping billions into the U.S. and world economy and the bailouts of banks, GM and Chrysler, the securities insurance giant AIG, and the giant mortgage agencies Fannie Mae and Freddie Mac. Suffice it to say that the severity of the downturn soon exceeded the recession of the early 1980s as stock prices cascaded downward, falling to their lowest level since 1997.

The troubles on Wall Street spread to Main Street, and as consumer confidence fell to a record low and wholesale and retail sales slowed, unemployment shot up to more than 10 percent of the U.S. workforce.

The political effects brought a Democratic landslide in the fall of 2008 that enabled that party to take control of the White House and Congress. The nation elected its first African-American president (doubly African-American, since his father was Kenyan and his mother an American) with the exotic name of Barack Hussein Obama.

Obama, who had been a little-known junior senator from

[407] Ibid., p. 20.

Illinois, was a gifted speaker and a cool, deliberative political player with sharp elbows who ascended to the White House on the mantra "Yes we can." The new Administration continued the stimulative policies of the Bush Administration, and the economy began to recover slowly, but unemployment remained stubbornly near 10 percent.

Foreclosures on defaulted home loans soared as the Great Recession deepened. (Bigstock Photo)

The electorate showed its unhappiness at the sluggishness of the recovery—and the spending involved in the bailouts of Wall Street and Detroit—by giving back control of the House of Representatives to the Republicans in the 2010 midterm elections and narrowing the Democratic majority in the Senate.

The Republican contingent in the House was considerably more conservative than in the past, thanks in part to the "Tea

Party" faction of the GOP—newly elected Representatives who came to Washington, D.C. vowing to change the way government worked and focused on reducing government spending rather than pushing economic stimulus programs.

Credit unions, most of which had a strong capital position and more freedom to lend than many larger institutions, found opportunities in the recession.

"Members-only nonprofit credit unions are having their turn in the sun as years of sticking to boring, old-fashioned banking practices—they typically hold the mortgages they make on their own books and only dabble in subprime—put them in a position to grab market share while national banks, auto finance companies, credit-card outfits and private student-loan firms cut back on loans," reported Time Magazine in October of 2008.[408]

Former NCUA executive and Callahan and Associates consultant Chip Filson pointed to the fact that credit unions stepped up to the plate when credit was tight. "During the 2008-2009 Great Recession there were only three sources of reliable institutional credit. The first was the federal government in the form of direct treasury loans, special programs like TARP, and FDIC guarantees. The second was Warren Buffet of Berkshire-Hathaway, who invested about $20 billion (in various firms like General Electric), and the third was the credit union system, which in those two years originated $25 billion in loans to 39 million borrowers."[409]

Credit union loans increased by 7.08 percent in 2008, including a 14.49 percent jump in first mortgage loans, counterbalancing a 6.17 percent drop in auto loans. However, loan growth stalled during the next two years, as unemployment remained stubbornly high.

Savings increased by 7.71 percent in 2008, with the biggest increase in rate sensitive shares—money market and IRA/Keogh accounts. Membership grew by 2.01 percent, to

[408] "Bad Times for Banks Mean Boom Times for Credit Unions," Time Magazine, October 23, 2008.

[409] Filson, Chip, Interview, May 20, 2011.

90.7 million members. Unlike loans, savings and membership continued to grow at a healthy pace over the next two years as consumers sought refuge in what appeared to be the safest part of the financial system. The result was that the loan to savings ratio fell from 83.2 percent in 2008 to 72.2 percent in 2010, while membership reached 92.6 million.

But credit unions could not escape the storm as some members lost jobs, fell behind in their mortgage payments, or went bankrupt. Moreover, credit union interest income fell with Fed rate cuts.

Loan delinquencies, defined as payments at least 60 days late, jumped from 0.67 percent of total loans to 1.38 percent by the end of 2008. Loan charge-offs, i.e., written off loans, rose from 0.51 percent of total loans to 0.85 percent.

Mortgage loan delinquencies grew from 0.67 percent of total real estate loans in 2007 to 1.20 percent by year-end 2008. And foreclosures more than doubled, from $330 million to $710 million. Credit unions were especially affected in the "sand states," such as Arizona, California, Florida, and Nevada, which were hit especially hard by the recession.

"Unprecedented high rates have been recorded for many key financial ratios, including real estate delinquency, aggregate delinquency, and net losses," NCUA Chairman Deborah Matz told the Senate Subcommittee on Financial Institutions in October of 2009.[410]

As a result of these and other factors, credit union earnings as measured by return on assets (ROA) declined sharply as the recession deepened. ROA, which already had been declining since the early part of the decade, dropped from 0.82 in 2006 to 0.63 in 2007 and then hit a low of –0.05 in 2008.

Nonetheless, even in the hardest-hit states, credit unions seemed to be in a better position than many banks. For example, in late 2008, while delinquencies at Nevada credit

[410] Matz, Deborah, Statement of the Chairman of the National Credit Union Administration, before the Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Financial Institutions,, October 14, 2009.

unions stood at 1.5%, this was a number that banks and other financial institutions "would kill for," Daniel Penrod, industry analyst for the California and Nevada Credit Union League, told the Las Vegas Review-Journal.[411]

Overall, in 2008, the U.S. bank loan delinquency rate was more than double that of credit unions, and in 2009, bank delinquencies shot up to 5.6 percent of outstanding loans, while credit union delinquencies rose modestly to 1.82 percent, declining to 1.75 percent by yearend 2010.

Large credit unions, above $500 million in assets, performed best among the asset groups during the recession. However, all asset classes had strong capital positions, and though capital to asset ratios declined somewhat due to an influx of savings, the average remained close to 10 percent.

ROA began to recover slowly as the recession eased, rising to 0.20 in 2009 and .39 in 2010. But by then credit unions found themselves on the hook for the cost of bailing out the corporate credit union system.

Chapter 73

Corporate System Totters

The corporate system was a valuable part of the credit union movement. More than 95 percent of credit unions belonged to one or more corporates. A little known fact was that you did not have to be a credit union to belong to a corporate. Other organizations that could use corporate services included credit union leagues and trade associations, credit union service organizations (CUSOs), certain banks, credit union political action committees, credit union charitable and educational foundations, and law firms, insurance agencies, and mortgage companies that were connected to the credit union industry.

Corporates, including U.S. Central, provided many correspondent-banking services. Three-fourths of credit unions

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[411] "Nevada CUs feeling strains, but ready to ride out economic storm," Las Vegas Review-Journal, p. 12, 16, 2008.

relied on corporates for settling accounts with other institutions.

Corporates also were a place to invest surplus funds or borrow when needed. Corporates acted as liquidity sponges for the surplus cash of their member natural-person credit unions. Their coffers swelled as member savings flowed into credit unions and then were invested in the corporates, they shrank whenever savings flowed out due to increased member loan demand. These inflows and outflows were largely beyond the control of the corporates, and managing them was a challenge.

In the 1990s, NCUA began permitting corporates to serve national fields of membership. By early 2000, eight federally chartered corporates had national FOMs, as did eight state-chartered ones, increasing competition. Competition fostered consolidation, By 2008, the number of corporate credit unions (excluding U.S. Central) had fallen from a high of 46 to 27.

The Government Accountability Office found the corporate system was under strain:

"Corporates face an increasingly challenging business environment that has created potential stresses on their financial condition. Like other financial institutions, corporates operate in an environment characterized by increasing competition, changing product and service offerings, and the continuous introduction of new technology – thus increasing the complexity of their operations, which in turn can impact their financial condition . . . .

"(Since 2000), a large influx of deposits coupled with low returns on traditional corporate investments has caused a downward trend in corporates' overall profitability because deposits/assets have grown more quickly than income . . . . To generate earnings, corporates increasingly have targeted more sophisticated and potentially riskier investments . . . . The corporates' changing business environment and their use of more sophisticated and potentially riskier investments increases the importance of NCUA regularly assessing its

oversight processes to ensure that corporates are properly managing these risks."[412]

Smaller credit unions relied heavily on their corporates as a safe repository for their surplus funds, but larger credit unions were increasingly looking outside the corporate system for higher returns on their investments. Navy Federal, the world's largest credit union, at this time did not even use corporate services, for example.

This added to the competitive pressure. To keep their larger members investing with them, corporates needed to offer attractive rates, which led them to purchase higher yielding securities. While NCUA restricted corporate investments to highly rated securities, this did not reduce the hunt for higher returns within the allowable investments, which included mortgage-backed securities.

The pressure for returns percolated upward through the corporate system. Smaller corporates continued to invest most of their surplus funds in U.S. Central, which in turn reinvested them. Larger corporates, however, which held much of the assets of the corporate system, had enough investment expertise (or so they thought) to seek higher returns on the open market and tended to rely less and less on U.S. Central for this purpose. This put pressure on U.S. Central to seek higher-yielding investments to keep its larger corporate members happy.

The search for high yields left a number of corporates out on a limb when the mortgage crisis hit.

As NCUA Chairman Deborah Matz explained to Congress, "In the mid-2000s, several of the largest corporate credit unions invested heavily in mortgage-backed securities (MBS), which resulted in concentrated exposure to the real estate market. Virtually all of the investments were AAA or AA rated when purchased.

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[412] "CORPORATE CREDIT UNIONS: Competitive Environment May Stress Financial Condition, Posing Challenges for NCUA Oversight," Report to the Ranking Minority Member, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 2004,GAO-04-977.

"However, their value plummeted when the housing bubble burst. In April, 2007, several months before the distress in the mortgage market surfaced, NCUA issued *Corporate Credit Union Guidance Letter No. 2007-02*. This letter addressed credit, liquidity, market, and concentration risks associated with mortgage backed securities (MBS). By and large, corporates ceased the purchase of non-agency mortgage-related securities by mid-2007.[413] At that time, all investments held by corporate credit unions, including MBS, were rated investment grade, and 98 percent were rated AA or higher.

"What began as a market disruption thought to stem from concerns with subprime products spread throughout the overall financial and real estate markets sector with unprecedented severity. By the time it became apparent that this was not an isolated market dislocation, there was no longer an active market for these types of securities. Like other financial institutions, the corporates could not have found buyers for the volume of these types of investments they held. The declining values of these mortgage-backed securities created severe liquidity and capital problems for these institutions."[414]

As the signs of economic turmoil grew in 2007 and early 2008, credit unions saw corporates as safe harbors for their surplus cash. But corporates began reporting "unrealized losses" as their mortgaged backed securities, especially "private label" securities not guaranteed by government agencies, slipped in market value. These losses were considered temporary, and they did not need to be charged against earnings or capital. But by December, 2008, corporates had accumulated $30 billion in unrealized losses, it was becoming clear that these would soon become "other than temporary impairments" (OTTIs) that would have to be charged against earnings and capital, rating agencies were downgrading

[413] I.e., not backed by government sponsored agencies like Fannie Mae.

[414] Matz, Deborah, Statement of the Chairman, National Credit Union Administration, "The State of the Credit Union Industry," Senate Committee on Banking, Housing, and Urban Affairs, December 9, 2010.

corporates, and alarmed credit unions were withdrawing funds.

This was a classic “run on the bank” in slow motion. By the end of 2008, credit union deposits in the corporate system had fallen from $92 billion in February to $59 billion, a plunge of 35 percent.

The corporates could not sell their mortgage-backed securities to meet withdrawals without being forced to take large losses, so they turned to borrowing against the securities on the open market. But as the value of this collateral shrank, it became more and more difficult to borrow. That autumn NCUA stepped in to staunch the deterioration. It estimated that if it did not act, the consequences would have been dire.

Many credit union deposits held by corporates were well above the level covered by the National Credit Union Insurance Fund (NCUSIF). “Without NCUA intervention, the losses, in their entirety, from immediate failure of large corporates would have cascaded to consumer credit unions via their uninsured shares in the corporates,” Chairman Matz told lawmakers.

“This would have resulted in the failure of approximately 1,000 consumer credit unions. Consistent with the manner in which deposit insurance functions, the costs of resolving these failures would have been borne by all remaining federally-insured credit unions, generating additional losses and failures. Ultimately, inaction would have resulted in massive disruption to consumer services and total costs to any remaining insured credit unions would have been far greater than the resolution strategy NCUA employed.”[415]

The problems were most severe at U.S. Central and four other corporate credit unions, which together held more than half the assets of the corporate system. NCUA took a number of steps to prop up the wobbling corporate system.[416]

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[415] Ibid.

[416] The following discussion draws on NCUA’s “Corporate System Resolution, NCUA Stabilization Actions, Frequently Asked Questions,” September 24, 2010.

In October, 2008, NCUA authorized corporates to issue new, unsecured debt obligations, which NCUA guaranteed. The Temporary Corporate Credit Union Liquidity Guarantee Program helped the corporates resume borrowing to meet their members' need for funds.

The following month, NCUA sought to inject additional cash into the corporate system by turning to the Central Liquidity Facility (CLF), which had not been a major player in the movement's progress since its founding in 1970. But now, like mild-mannered Clark Kent emerging from the telephone booth as Superman, the CLF had a significant role to play.

The CLF had statutory authority to borrow up to $41 billion from the U.S. Treasury to meet credit union liquidity needs, but Congress had imposed a borrowing cap of $1.5 billion. NCUA had already requested—and Congress had granted—permission for the CLF to borrow up to the full $41 billion from the Treasury.

The CLF could not lend directly to corporates, NCUA said (although the corporates and Chip Filson argued with this), but it could lend to credit unions.[417] With advice from Treasury and the Fed, NCUA devised a way to funnel CLF money to the corporates through their credit union membership.

The Credit Union System Investment Program (CU SIP) was

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[417] Association of Corporate Credit Unions (ACCU) and the Corporate Credit Union Network, "Addressing Current and Long-Term Issues in the Corporate Network: An Action Framework," December 8, 2008, submitted to NCUA. Cited in "Corporate Crisis & Regulatory Reform, a Callahan Report Special, Volume 26, Number 10, 2010. The corporates argued that the legislation establishing the CLF authorized loans to members and noted that the corporates were associate members of the fund. They proposed that the CLF could purchase corporate troubled assets with the understanding that the corporates would buy them back later when the economy improved and the assets stopped their free-fall in value. Or the CLF could make direct deposits in, or investments in, the shares of corporate credit unions. This presumably would have given the corporates a helping hand while they continued their important work for credit unions and gradually recovered their financial health. In the Callahan Associates report, Chip Filson notes that "During the Penn Square banking crisis . . . . the CLF loaned to both corporates and to credit unions...to assure depositors that funds were available."

authorized in November, 2008. It permitted credit unions to borrow from the CLF to purchase corporate notes that paid the credit union 0.25 percent more than the CLF was charging the credit union for the money. The notes were guaranteed by NCUA, so it was a no-brainer proposition. CU SIP injected $8.2 billion into the corporates, which in turn used the money to pay off external borrowings.

The same month, NCUA launched the Credit Union Homeowners Affordability Relief Program (CU HARP), which helped funnel cash to the corporates and also helped homeowners having mortgage difficulties. Like the CU SIP program, a credit union could borrow from the CLF to buy corporate notes paying a higher rate. The notes paid an additional one percent if the credit union provided documented interest rate relief for distressed borrowers. CU Harp raised a total of $164 million.

Finally, in January, 2009, NCUA took the step of temporarily insuring all credit union deposits in corporates, even sums in excess of the insurance limit of $250,000. (Although paid in capital and membership capital shares were not covered.) The Temporary Corporate Credit Union Share Guarantee Program finally stopped the slow run on the corporates. Within a month after the guarantee was proclaimed, credit union deposits in corporates had grown to $80 billion. This halted the corporate need to sell their mortgage-backed securities at a loss.[418]

Up to this point, the credit union movement was generally behind NCUA's efforts to stabilize the corporate system. But NCUA's next moves would create tremendous controversy, as it placed U.S. Central and WesCorp into conservatorship.

[418] The insurance did not cover credit union paid-in capital and membership capital accounts that served as part of a corporate's capital. As we shall see, credit unions would suffer losses in these accounts, part of the collateral damage of the corporate crisis and NCUA's attempts to deal with it.

Chapter 74

The Fall of U.S. Central

A 2010 report by NCUA's Office of the Inspector General (OIG) found that U.S. Central's management and NCUA shared responsibility for the top corporate's demise.

"Since 2001, U.S. Central had modest growth and a generally conservative investment strategy," the report stated. "However, in 2006, U.S. Central's business strategy shifted toward more aggressive growth that was focused on increasing or maintaining market share of (member corporate accounts) by offering competitive investment products and rates."[419]

"We are taking on prudent increases in risk in order to gain market share," stated the October, 2006, minutes of U.S. Central's Asset and Liability Committee.[420] Its assets, 80 percent of which were invested, rose by 22 percent over 2006 and 2007 to $44.7 billion.

Most of the new money was invested in mortgage-backed securities, whose share rose from 55-57 percent of U.S. Central's investment portfolio to 63 percent over the same period More than half of these mortgage securities were backed by higher yielding, higher risk subprime and Alt-A mortgages that were being originated just as the subprime mortgage market was cresting. However, the rating agencies were still giving most of these securities AAA ratings, their highest score for safety.

The growth in assets was outpacing U.S. Central's capital. Its ratio of capital (retained earnings plus paid-in capital and membership capital), to assets shrank from 5.8 percent to 5.1 percent over the same 14-month period.[421]

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[419] Material Loss Review of U.S. Central Federal Credit Union, National Credit Union Administration Office of Inspector General, Report #OIG-10-17, October 18, 2010, p. 2.

[420] Ibid., p. 18.

[421] Paid-In Capital consists of credit union investments in a corporate that have no term limit, are uninsured, and are available to cover losses that exceed retained earnings. Membership Capital is similar except it can be withdrawn after three years.

By 2007, unmistakable signs of trouble in the mortgage market were appearing as the rating agencies began downgrading subprime mortgage-backed securities. Despite this, U.S. Central remained confident that it could handle any problems.

"The few exposures that we were mostly concerned about have been sold," stated the July 6, 2007, minutes of U.S. Central's Asset and Liability Committee. "There are a handful of exposures that we are still watching aggressively. The trading desk and credit department staff are working together to ensure that we have no real concerns in the portfolio."[422]

NCUA's on-site examiners seem to have taken U.S. Central at its word. "(Examiners) had few criticisms of U.S. Central's operations or its management," according to the OIG report.[423] They gave U.S. Central's investment policies and capital strength a thumbs up.

But in 2008, as the mortgage-backed securities market foundered, examiners grew more critical and began to downgrade U.S. Central's financial risk scores. NCUA began working with U.S. Central and the other corporates to devise ways to keep their losses from escalating.

By early 2009, the declining value of its investments had severely eroded U.S. Central's capital, and its Net Economic Value was deep in negative territory. (NEV is the difference between the fair value of the credit union's assets, and the fair value of its liabilities.)

NCUA believed action was needed to keep U.S. Central afloat—primarily because it had an essential role in payment systems processing and check and credit card settlement, the loss of which would "potentially affect nearly every consumer credit union, and would have devastating repercussions for

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[422] Material Loss Review of U.S. Central Federal Credit Union, National Cre dit Union Administration Office of Inspector General, Report #OIG-10-17, October 18, 2010, p.19.

[423] Ibid., p. 23.

tens of millions of consumers."[424]

When U.S. Central estimated in early 2009 that it faced an additional loss of $1.2 billion in the value of its securities, NCUA bolstered U.S. Central's capital in the form of a $1 billion "capital note" that transferred the sum from the share insurance fund to U.S. Central. This enabled the corporate to continue operating.

By this time, the situation had also become very serious at WesCorp, the nation's largest "retail" corporate, with nearly $25 billion in assets. With a national field of membership, WesCorp served some 1,100 natural person credit unions, mainly on the West Coast but also as far away as American Samoa. As 2009 progressed, the potential losses in mortgage-backed securities at both U.S. Central and WesCorp continued to mount, and NCUA decided stronger action was needed. On March 20, 2009, the NCUA Board placed U.S. Central and WesCorp into conservatorship and loaned each corporate $5 billion from NCUSIF to maintain liquidity. This meant NCUA took control, replacing the boards of the two corporates, their CEOs, and some key personnel whose decisions in NCUA's view had placed the institutions in peril.

The costs of dealing with the corporates affected the National Credit Union Share Insurance Fund (NCUSIF).

NCUSIF ordinarily hovered around $1.30 for each hundred dollars on deposit with credit unions. By the end of 2008, due to demands on the fund, the insurance fund's equity ratio had declined to $1.26. This meant an additional charge to credit unions above and beyond their normal one percent deposit, at a time when they were facing economic challenges due to the recession. Despite the premium, the fund's equity ration sank to $1.23 by yearend 2009, requiring additional charges to credit unions.

The situation alarmed the managers and boards of credit unions, many of who felt stung by the prospect of paying for

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[424] "Corporate System Resolution, NCUA Stabilization Actions, Frequently Asked Questions," National Credit Union Administration, September 24, 2010.

the mistakes of the corporate system. They also felt shut out of NCUA's decision-making.

Two questions raised, as in the furor over NCUA's seizure of Capital Corporate in 1995, were whether NCUA had accurately estimated the corporates' losses and whether it had acted prematurely in seizing them. In particular, many credit unions demanded that NCUA release the findings of the consulting bond investment firm, PIMCO, whose 4,500-page report on the investments of the two corporates had helped the agency make its decision to take over U.S. Central and WesCorp. There appeared to be a conflict of interest in hiring a firm to estimate the value of securities that it might be purchasing at some point.

NCUA refused to make the PIMCO report public, arguing it contained proprietary information. CUNA mounted a campaign to have the report released so outsiders could evaluate its merits, even threatening legal action. It also called for spreading out the costs of the corporate rescue to make them more manageable for credit unions to pay.

"Every single credit union in the nation that has had an opportunity to weigh in has expressed concern, outrage, anger, and frustration with the current situation," CUNA President Dan Mica said in a letter to NCUA board members shortly after the takeover of U.S. Central and WesCorp. CUNA members bombarded the NCUA board with e-mail messages on the same topic.[425]

Credit unions and their trade associations also made their views known in hundreds of comments responding to NCUA's proposal in January, 2009, to amend its corporate rules, revisions designed to prevent such a situation arising again.

"We have significant concerns that the Board's strategy, as crafted and implemented to date, does not fully take into account the serious repercussions to the natural person credit union system and, as a result, to consumers and credit union members," wrote Teresa Freeborn, CEO of $770-million-asset

[425] "CUNA threatens NCUA with legal action over corporate takeovers," Credit Union Journal, January 27, 2009.

Xceed Financial Federal Credit Union, El Segundo, California.[426]

"This concern has been further sharpened by NCUA's unexpected actions on March 20, 2009, involving U.S. Central Federal Credit Union and Western Corporate Federal Credit Union (WesCorp), which will have an especially pronounced effect on credit unions in the Western states. Our fear is that unless alternative methods and tools are used to soften the staggering financial blow of NCUA's actions, some credit unions may never fully recover from its impact."[427]

Already, to take the burden of dealing with the corporate situation off the insurance fund's back, NCUA in March had asked Congress to authorize creation of a Temporary Corporate Credit Union Stabilization Fund. President Obama signed the measure in May of 2009.

The Stabilization Fund had authority to borrow from the Treasury, the money to be repaid by assessments on federally insured credit unions. The first thing the Fund did was to assume the $1 billion insurance fund loan to U.S. Central, thus removing the burden of this obligation from the fund. The Stabilization Fund also covered the costs of NCUA's other actions connected with the corporate rescue. The most important aspect of the Fund, from the point of view of credit unions, was that the costs of repaying Treasury would be spread over seven years, making it somewhat easier for credit unions to handle the expense of reimbursing Treasury.

NCUA and the trade associations were careful to note that the rescue of the corporate system did not constitute a taxpayer bailout—rather, the Stabilization Fund's borrowing from the Treasury would be repaid by credit unions eventually.

Some credit unions, however, did not believe in keeping the

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[426] Until 2008, Xerox Federal Credit Union.

[427] Freeborn, Teresa, "Comments on Corporate Credit Union Strategy," April 6, 2009, Letter to NCUA in response to NCUA's Advanced Notice of Proposed Rulemaking on Corporate Credit Union Strategy. Many of the letters NCUA received duplicated each other in certain ways, indicating league and trade association input.

problem within the credit union movement. “We are adamantly opposed to the NCUA Corporate Stabilization program as it has a severe and significant impact on natural person credit unions. The NCUA has been aware of issues facing the corporate credit unions for a long time and have decided to look the other way rather than dealing with the problems. Now, we are being punished for the administration’s failure to act,” wrote Board Chairman Walter Behrman and CEO Joseph Prokop of $159-million-asset TEG Federal Credit Union, Fishkill, New York.[428]

“We have sat in on the (NCUA) webinars and can't believe what we're hearing, that the corporates have used up all of their paid in capital, approximately $8B and will probably use up the additional $4.7B being squeezed out of natural person credit unions.[429] Where will it end? Where will the next monies come from that will be needed to support the corporates since the total exposure could be as high as $80B as stated by representatives from the NCUA?”

The two credit unionists suggested, as did some other commentators, that NCUA be allowed to share in the Troubled Assets Recovery Fund (TARP) established by Congress to rescue banks and other major institutions.

“The NCUA should do everything in their power to gain access to TARP funds to support the corporates, rather than drag the whole industry down by assessing premiums and undue charges on natural person credit unions. This will have a detrimental effect for years to come on the credit union industry. In essence what the NCUA is doing is robbing us of our capital reserves that we have built up to support our credit unions so that we can absorb losses incurred in difficult economic times and provide us the ability to grow and expand our business to effectively serve our membership.

“It appears that the reasoning behind not gaining access to

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[428] Behrman, Walter and Joseph Prokop, Letter to NCUA in response to NCUA’s Advanced Notice of Proposed Rulemaking on Corporate Credit Union Strategy. March 13, 2009, National Credit Union Administration.

[429] Natural person meaning serving individuals, not credit unions.

TARP funds is one of self preservation by the NCUA and the various trade organizations. The thought is that if we use taxpayer funds to bailout the corporates that we will eventually be taxed. The NCUA would then be merged into the FDIC and the credit union trade organizations will cease to exist. That may not be a bad thing! It certainly would be easier to pay taxes than getting our capital stolen by the agency watching over the insurance fund."

To respond to NCUA's request for comments on changing corporate regulations, CUNA and NAFCU organized a joint task force to come up with recommendations. Among other points, the task force on September 3, 2009, proposed:

● A much more limited role for corporates in which they would provide payment system and settlement services that require only short-term deposits and lending functions.

● Creation of Credit Union Service Organizations (CUSOs) by corporates to provide longer-term investment services to credit unions. The CUSOs, not the corporates, would hold the investments on their books.

● A single tier of corporates (i.e., without a capstone like U.S. Central) and continued national fields of membership, common capital requirements, corporate Prompt Corrective Action, and significant limits on risk taking. The limits on risk-taking would mean, the associations argued, that competition among corporates in the future would be driven by efficiency. This would place a premium on economies of scale, creating substantial pressures for consolidation.[430]

More than a year later, on September 24, 2010, NCUA placed an additional three corporates into conservatorship—$1.3 billion Constitution Corporate in Connecticut, $8 billion Member's United Corporate in Illinois, and $7.5 billion Southwest Corporate in Texas.

Taken together, the five corporates in NCUA conservatorship held more than 90 percent of the impaired

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[430] CUNA-NCUA Corporate Credit Union Restructure Task Force, Report and Recommendations, September 3, 2009.

assets in the system, accounting for 98 percent of the losses on mortgage-backed securities.

To enable their member credit unions to continue receiving services, NCUA moved the failed corporates' operations and good assets into four newly chartered "bridge" corporates that would operate for two years until member credit unions found new providers. The impaired assets would be sold when market conditions improved, and the losses—which were still expected to reach tens of billions of dollars—would be absorbed by the Stabilization Fund.

In the end, credit unions took a large hit amounting to millions of dollars to their earnings and capital from the near-collapse of the corporate system. In addition to the additional premiums all credit unions had to pay to restore NCUSIF to its target funding, the surviving corporates lost their membership capital shares in U.S. Central. Natural person credit unions had to write off all their capital shares in the four failed "retail" corporates. Finally, all had to pay years of special assessments to repay the Treasury for the borrowings of the Corporate Credit Union Stabilization Fund.

Chip Filson argued that NCUA's seizures of U.S. Central and four other corporates amounted to nationalization of the corporate system and cost the movement far more than necessary. The previous NCUA actions had stabilized the corporate system, he claimed, and the corporates were beginning to recover their health. By seizing the corporates and the troubled assets that would have bounced back in value, and then selling the assets at fire-sale prices, Filson believed, NCUA caused needless harm to the movement.[431]

As we have seen, credit unions' return on average assets hit an all-time low of minus 0.05 percent in 2008, and the following year the return reached only 0.20, although the economy was gradually pulling out of the recession. The outlook was brighter in 2010 as the average ROA rose to 0.39 percent.

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[431] Filson, Chip, "Corporate Crisis & Regulatory Reform," A Callahan Report Special, Callahan and Associates, 2010.

Some credit unions, in an attempt to preserve their capital, were opting to shrink their insured savings to reduce NCUSIF premiums. They were doing this by reducing the rates they offered on savings and by encouraging marginally profitable members to withdraw their funds.

The corporate situation also was renewing credit union interest in converting to bank charters, reported consultants in the field. However, this did not seem to result in any surge of conversion attempts.

Community development credit unions (CDCUs) were hit especially hard by the Great Recession, reported Cliff Rosenthal of the National Federation of Community Development Credit Unions (NFCDCU). CDCUs had less capital to absorb their losses and they served communities "with unemployment and poverty rates far above the national average," he wrote.

"Their struggle was compounded by heightened regulatory pressure: determined to minimize additional losses, NCUA assumed an aggressive stand in examining credit unions, pressing for write-downs of loan portfolios and implementing 'Prompt Corrective Action' (PCA) when credit unions sank below the statutory 'well capitalized' standard of 7 percent net worth-to-assets. The toll has been great, as reflected in the increased numbers of liquidations or forced mergers of CDCUs, further decreasing service to low-income communities."

But Rosenthal noted a positive side: "Despite formidable economic and regulatory pressures, many CDCUs not only survived, but grew over 2008-2010. They were aided by widespread public revulsion at the bailout of the largest banks, which prompted calls by social media and even mainstream financial publications to 'move your money' into local credit unions and banks. Even more important, many CDCUs were aided by the programs of the U.S. Treasury Department and the (Community Development Financial Institutions Fund)."[432]

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[432] Rosenthal, Cliff, "Credit Unions, Community Development Finance, and the Great Recession," Federal Reserve Bank of San Francisco, Working Paper 2012-01, p. 25. The aid he refers to came from the Treasury Department's

On September 1, 2010, NCUA published a new set of regulations for corporate credit unions that hewed fairly closely to the recommendations of NAFCU and CUNA. The new rules left the corporate system pretty much free to evolve on its own, but with more safeguards. "These amendments are designed to work collectively to strengthen corporates and the corporate system," NCUA said. "No one change will prevent inordinate risk going forward, but all the provisions taken in concert will be effective in preventing systemic risk."[433] For details of the new rule, see Appendix C.

Chapter 75

Decade's End

The decade ended with the credit union movement still relatively strong, but with the future uncertain. Although the recession had officially ended in 2009, unemployment remained stubbornly high and many economists foresaw a years-long period of slow growth, if not a double-dip recession. Debt problems in the Mediterranean members of the euro zone added to concerns.

Even though some credit unions tried to discourage savings inflows, the movement continued to grow as Americans cut back on their borrowing and sought to reduce their debt burden. Credit union lending flattened out, with loan volume actually falling 1.5 percent in 2010, the greatest decline since World War II. Loan delinquencies continued to be a problem, reaching 1.75 percent in 2010.

The year 2010 saw a change in CUNA leadership as Dan Mica retired in June after serving longer than any previous CUNA CEO. The organization's board selected the president of the California and Nevada leagues, Bill Cheney, as Mica's successor. The appointment was a return to the association's

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Community Development Financial Institutions Program and its Community Development Capital Initiative.

[433] Corporate Credit Union Regulatory Reform, Summary of Draft Final Amendments to Corporate Rule, September 1, 2010, National Credit Union Administration.

practice of selecting its leadership from inside the credit union movement. Though not a professional lobbyist like Mica, Cheney, a former Eagle Scout and credit union executive, had extensive experience in dealing with Congress.

Symbolic of the changes in the U.S. credit union movement since 1970, this is the Fish Hatchery Road branch of Summit Credit Union, formerly plain vanilla CUNA Credit Union of Madison, Wisconsin, which served (and still serves) CUNA, CUNA Mutual, and Credit Union System personnel. Through mergers and expansion into other communities, it now is Wisconsin's second largest credit union, with some $1.85 billion in assets, and offers a full range of financial services. (Author Photo)

Ever since the battle for the Credit Union Membership Access Act in 1998, CUNA and NAFCU had been more closely coordinating their lobbying efforts in Congress. Talk of merging the two organizations remained just talk, however. Since Cheney had been active in both NAFCU and CUNA affairs, it seemed likely that the two associations would continue their coordinated efforts.

With many new lawmakers in Congress and in state legislatures as the next decade opened, credit unions faced challenges in educating the newcomers about credit union issues. The new emphasis on reducing the national debt sparked discussion of a possible need for new revenue through eliminating various tax loopholes, which, of course, raised the specter of credit union taxation.

Debit card "swipe fees" became a bone of contention for credit unions. (Bigstock Photo)

NAFCU and CUNA still sought to raise the limits on member business loans and to authorize sources of secondary capital to help credit unions rebuild their capital after the Great Recession.

More immediately, they sought to have the Federal Reserve fairly enforce the new Financial Reform law that empowered the Fed to reduce the interchange fees paid by merchants on debit card transactions.[434]

Merchants were accustomed to paying an average of about 44 cents per debit card "swipe," but had succeeded in getting Congress to give the Fed authority to cut the average fee.

A single transaction fee may seem like a small amount, but consumers were using debit cards to pay for some 35 percent of all purchases, according to the Financial Services Roundtable. In total, they paid some $20 billion annually for the convenience, according to the National Retail Federation.

Retailers said the reduction in the fee would save money for consumers but opponents, including the credit union associations, said it would simply go to increase merchant profits. The credit union movement argued it needed the higher fees to help restore its financial stability and provide adequate services to its members.

The Federal Reserve in December, 2010, initially proposed capping the interchange fee at 12 cents. But after overwhelmingly negative comments from credit unions and other debit card issuers, its final ceiling was 24 cents.

Moreover, debit card issuers under $10 billion in size were exempted, which included most credit unions. However, that left credit unions open to the danger of merchants refusing to accept debit cards except from large institutions subject to the Fed's mandate.

Conclusion

The U.S. credit union movement has faced many rocky moments—the Great Depression, World War II, the inflation of the 1970s, deep recession of the early 1980s, terrorism and natural disasters, and the Great Recession of late 2007-2009. But each time it has picked itself up and moved on to continue

[434] The transaction fee helps pay the costs of operating the electronic system that allows the use of credit and debit cards.

serving its members and the American community. In looking back, one might ask the secret of the movement's success in surviving these and other challenges. The responses that come to mind include:

- Focus by volunteer boards and management on member service, not on extracting the maximum return from transactions.

- Prudence in handling the resources of the credit union and avoiding undue risk.

- Rapid adaptation to changing circumstances, such as advances in technology.

- Strong regulation by federal and state credit union supervisors who believe in and support the credit union mission of service.

- Cooperation among all segments of the movement to give each credit union the benefit of the knowledge and experience of other credit unions.

- Movement unity that gives credit unions a strong, grassroots voice in Congress and state legislatures to create a favorable legal environment for credit unions.

We can reasonably expect credit unions will continue to be a major positive factor in our economic life for years to come.

Thank You

Many thanks to the dozens of credit unionists who kindly agreed to be interviewed for my earlier researches or this book. The ones quoted in this book are identified in the text and footnotes.

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manuscript of this book and made many useful suggestions, and who also gave me constant encourage-ment.

I invite readers of this history to contact me with comments, criticisms, or corrections by mail to 2241 South Syene Road, Fitchburg, Wisconsin 53711.

Paul Thompson

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About the Author and This Book

A graduate in English of the University of Wisconsin-Madison, Paul Thompson began his career as a newspaper reporter. After working on two newspapers, he became a writer for and then editor-in-chief of a weekly current events filmstrip viewed by hundreds of thousands of children.

After 17 years at that work, he and his wife Evelyn established a free-lance writing, editing, and public relations agency working mainly with trade associations and corporations. He also published several science books for young people and an easy-reading novel for teenagers.

A credit union member since his cub reporting days, Thompson joined the public relations department of the Credit Union National Association (CUNA) in 1986, where he was speechwriter for the elected leadership and the president's office. He retired in 1998 but continued writing speeches, articles, and training manuals for CUNA and the World Council of Credit Unions.

Thompson is a Credit Union Development Educator. Long interested in credit union history, he was hired by CUNA's Information Resource Center (IRC) to research and write a history of the movement from 1980 to 2000, including interviewing many credit union leaders. This history has been used as a resource by the IRC in responding to queries.

Thompson independently continued his research and interviewing, which resulted in this book, a completely new and detailed look at the development of the modern U.S. credit union movement.

Thompson has also written a novel, *The Credit Union Lady*, which dramatizes the early days of the credit union movement. It is set in a fictional small Wisconsin city.

Thompson and his wife are members of several credit unions, a farm services cooperative, and a writer's collective that produces a monthly radio program of original poetry, essays, and music broadcast by some two dozen community radio stations around the nation.

Appendices

Appendix A

Credit Union Legal and Regulatory Changes

1977-2010

(Adapted and Expanded from Economic Review, June, 1984, Federal Reserve Bank of Kansas City)

1977 Amendments to Federal Credit Union Act

- Increased loan maturities on nonresidential loans to 12 years.
- Allowed 30-year residential mortgage loans and 15-year mobile home and home-improvement loans.
- Permitted self-replenishing lines of credit.
- Permitted participation loans with other financial institutions.
- Permitted government-insured or guaranteed loans.
- Lowered reserve formula for larger credit unions.
- Allowed different types of share accounts, including share certificates.

1978 Financial Institutions Regulatory and Interest Rate Control Act

- Restructured NCUA into three-member board, of which one served as chairman.

● Established Central Liquidity Facility under NCUA Regulations

● Permitted sale of mortgages to FNMA, FHLMC, or GNMA.

● Set maximum rate on small share certificates at 8 percent.

● Permitted market rates on large share certificates ($100,000 or more).

● Permitted six-month $10,000 certificates paying ¼ percent above the six-month Treasury bill rate.

1979 Congress

● Gave 90-day authorization (starting December 28) for credit unions to offer share drafts. (NCUA regulations required credit unions with more than $2 million in assets or offering share drafts to hold 5 percent of member accounts plus notes payable in liquid assets.}

1980 Depository Institutions Deregulation and Monetary Control Act

● Classified credit unions as depository institutions.

● Gave permanent authority for share drafts.

● Set required reserves on share drafts.

● Established timetable for phasing out interest ceilings.

● Raised loan rate ceiling to 15 percent and authorized NCUA to increase this ceiling. (NCUA raised loan ceiling to 21 percent for nine-month period starting December 3.)

1981 NCUA regulations

● Extended 21 percent loan ceiling to June, 1982.

● Allowed credit unions to make variable interest rate consumer and mortgage loans.

1982 Garn-St Germain Depository Institutions Act

● Freed credit unions to set par value of shares and to determine internal organization.

- Eliminated limits on size and maturity of mortgage loans, allowed refinancing of first mortgages, and extended maturity limits on second mortgages.
- Excluded credit unions with less than $2 million in reservable accounts from reserve requirements.
- Permitted Central Liquidity Facility (CLF) to lend to the National Credit Union Share Insurance Fund (NCUSIF) and also made CLF an agent of the Federal Reserve System.

1982 NCUA regulations

- Allowed credit unions to determine the kinds of shares offered and the dividend rates paid.
- Repealed fixed liquidity requirement on federally insured credit unions.
- Permitted credit unions greater flexibility in the kinds of services they can offer and the joint sharing of activities with other credit unions.
- Permitted federal credit unions to serve more than one group, as long as each group had a common bond.

1983 NCUA regulation

Expanded definition of "family member" in common bond requirements.

1984 Deficit Reduction Act

Recapitalized the National Credit Union Share Insurance Fund by requiring federally insured credit unions to deposit an amount equal to one percent of their insured savings. The so-called "One percent Solution."

1987 Expedited Funds Availability Act

This act regulated check holds. The Federal Reserve's Regulation CC, which was adopted to implement the Act, contained a section that would have effectively eliminated "payable through" credit union share drafts. That section was ruled illegal by the Federal Court of Appeals for the District of Columbia in a lawsuit brought by CUNA.

1991 Truth in Savings Act

Required financial institutions, including credit unions, to inform savers of the annual percentage yield (APY) on savings to make comparison of savings yields easier for consumers.

1997 NCUA regulation

Banned interlocking relationships between leagues and corporates as a "conflict of interest."

1998 Supreme Court decision

Overturned NCUA's 1982 liberalized field of membership regulation allowing federal credit unions to serve more than one group.

1998 Credit Union Membership Access Act (CUMAA)

Responded to Supreme Court's field of membership decision by allowing federal credit unions to serve more than one group. It also established net worth requirements for federal credit unions backed up by a system of Prompt Corrective Action and restricted member business lending to 12.5 percent of a credit union's assets or 1.75 percent of its reserves, whichever was less.

2001 USA Patriot Act

Expanded government anti-terrorism powers, with new requirements on depository institutions, including credit unions. Credit unions were required to set up anti-money laundering programs and stricter identification of individuals seeking membership.

2009 NCUA regulations

As a result of corporate losses due to the Great Recession, NCUA seized control of U.S. Central Credit Union and WesCorp.

2010 NCUA regulations

NCUA seized control of three more large corporates. It established four "bridge corporates" to take over the functions of the conserved corporates temporarily and adopted new corporate regulations aimed at reducing corporate risk-taking.

The end result looked to be a smaller, restructured corporate system without U.S. Central.

Appendix B
Hunting the Wild CURIA

One of the first bills to materialize in the search by credit unions for regulatory relief was H.R. 3951, the Financial Services Regulatory Relief Act of 2002, introduced in the second year of the 107th Congress. Like many financial legislative initiatives, it was an omnibus measure designed to provide something for every major depository lobbying group. It thus included a section dealing with credit union powers. This section did not address the major credit union concerns but was supported by NCUA and the movement.

The bill was introduced in the House on March 13, 2002, by Representatives Shelley Moore Capito (R-West Virginia) and Max Sandlin (D-Texas). The Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee held two hearings, first to listen to the regulators and then the regulated.

As was customary, credit union representatives did not comment on the banking provisions of the bill. However, CUNA's representative took a pot shot at the banks. "We understand that the ABA and other bank trade associations oppose all or parts of this bill because of the credit union provisions. We will not lower ourselves to their level and attack provisions pertaining to them," stated Charlene Gaither, manager of the Eastern Panhandle Federal Credit Union, Martinsburg, West Virginia.

In their testimony, bankers did express their opposition to greater powers for credit unions in light of their tax-exempt status. This drew a rebuke from the chairman of the subcommittee, Spencer Bachus (R-Alabama).

"You all went to public school, right? Have you ever been in a food fight? You know, food fights get you in trouble when

you are in school. They usually are not that constructive. Our aim here is to have win-win situations. It is to take regulations, things the regulators are doing, things that cost you money that you don't have available to loan out, and try to eliminate those regulations that make no sense, or barriers that make no sense . . . . I would use your dynamite and your political might in looking at things that will benefit your institutions and the consumers you serve in eliminating barriers."

CUNA and NAFCU suggested strengthening the credit union provisions of the bill, but the banking industry blocked their efforts. Even the bill as it was took four years to wend its way through Congress. On October 13, 2006, President George W. Bush signed the Financial Services Regulatory Relief Act into law.

The credit union section of the new law provided only minor changes to existing law: It:

1. Gave military and civilian authorities responsible for buildings erected on Federal property the discretion to extend to credit unions that finance the construction of credit union facilities on Federal land real estate leases at minimal charge.

2. Increased the maturity limitation on Federal credit union loans from 12 to 15 years.

3. Amended the Federal Credit Union Act to allow Federal credit unions to sell negotiable checks, money orders, and other similar transfer instruments, including international and domestic electronic fund transfers, to anyone eligible for membership, regardless of their membership status.

4. In response to an anticipated change in accounting principles, amended the Federal Credit Union Act's prompt corrective action (PCA) requirements to allow a credit union to include as part of its net worth the retained earnings of any other credit union with which the credit union had merged.

The credit union movement had another string to its legislative bow in the form of the Credit Union Regulatory Improvement Act (CURIA), H.R. 3579, introduced in late 2003 by Representatives Edward R. Royce (R-California) and Paul

Kanjorski (D-Pennsylvania). Its most significant provision was raising the member business loan cap from 12.25 percent of credit union net worth to 20 percent.

"This is the first time a proactive credit union bill has been introduced that wasn't in response to a crisis," said Gary Kohn, CUNA's vice president of legislative affairs and senior legislative counsel.

The bill was largely an initiative of the California League working closely with CUNA. However, NAFCU and the National Association of State Credit Union Supervisors (NASCUS) were interested in backing it, and in a meeting in January, 2004, in Credit Union House in Washington, D.C., the three major trade groups hammered out a common legislative strategy on CURIA.

However, despite intense lobbying by the movement, CURIA remained in the House Financial Services subcommittee in 2004. As H.R. 2317, it was reintroduced, with modifications, by Representative Royce in May 2, 2005. The legislation had more than 70 co-sponsors by July 5. The refreshed CURIA bill contained two important titles:

Title I—Capital Reform

This title reformed the prompt corrective action (PCA) system for federally insured credit unions. After six years NCUA sought adjustments that provided supervisory flexibility and incorporated a more risk-based approach.

CURIA provided more flexibility to the statutory requirements of the PCA system. The bill reduced the standard net worth ratio requirement for credit unions to a level comparable to what was required of institutions insured by the Federal Deposit Insurance Corporation. The proposal included a more risk-based approach to credit union capital standards. The legislation modified the requirements for net worth restoration plans imposed by the NCUA.

Title II—Economic Growth

This title amended the authority of federal credit unions to make member business loans. The aggregate limit on a credit

union's net member business loan balances under the Credit Union Membership Access Act (CUMAA) was the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. CURIA sought to replace this limitation with a flat rate of 20% of the total assets of a credit union. NCUA's definition of a member business loan excluded loan(s) that are equal to or less than $50,000. CURIA would have amended the definition to exclude loans of $100,000 or less.

The bill also contained some significant measures concerning credit union governance.

- It provided for the expulsion of a federal credit union member for a good cause by a majority vote of the institution's board of directors rather than a two-thirds vote of the membership. The bill also gave institutions the authority to limit the number of consecutive terms an individual could serve on the board of directors in an effort to encourage broader representation on the board. Finally, federal credit unions would be able to reimburse volunteer board members for wages they would otherwise forfeit by participating in credit union affairs.

- To ensure that the membership of a credit union understood the ramifications of conversion to a for-profit charter, the bill required a majority vote of at least 20% of the membership to approve a conversion. Under CUMAA, the membership could approve the proposal to convert by a majority of those members who voted on the proposal.

Like its predecessor, the bill did not progress beyond the House Financial Services Committee.

A new CURIA bill, H.R. 1537, was introduced in March, 2007. It indicated continuing concern about credit union conversions by requiring at least 30 percent (rather than 20 percent as in the previous version) of a credit union's membership to take part in voting before any conversion could be approved. Again, the bill never emerged from committee.

Appendix C
NCUA's New Corporate Rule

NCUA's final rule sought to strengthen corporate capital requirements and make them more consistent with the international capital requirements for banks. Among other things, the rule:

- raised corporate capital requirements, to be phased in over a period of years.
- required Prompt Corrective Action by a corporate if it fails to meet capital standards, ranging from a prohibition on dividend payments to conservatorship or liquidation.
- tightened restrictions on permissible investments by corporates, including prohibiting purchase of "private label" residential mortgage-backed securities (RMBS), subordinated securities, collateralized debt obligations (CDOs), and net interest margin securities (NIMs).
- required the weighted average life of a corporate's loans and investments be 2 years or under.
- placed additional limits on corporate borrowing.
- required that all corporate board members hold either a CEO, chief financial officer (CFO), or chief operating officer (COO) position at their member credit union or other member entity, and that a majority of the board members represent credit unions.
- required that each corporate annually disclose the compensation of its highest paid employees and outlawed "golden parachute" payments to a departing official of a troubled, under-capitalized, or insolvent corporate.
- required corporate credit union service organizations (CUSOs) to serve credit unions primarily, to restrict their services to those related to the normal course of business for credit unions, and to get NCUA approval for their activities.

The new capital requirements appeared likely to hasten the consolidation of the corporate system by forcing under-capitalized corporates to merge or liquidate. The amendments did allow corporates to require members to contribute capital as a condition of membership or receiving services. However, whether credit unions would step up to the plate was unclear. And by confining corporates to short-term investments and loans, the new rule considerably narrowed corporate activities.

What the new rule *did not do* was limit a corporate's field of membership to one region or limit the ability of a credit union to belong to more than one corporate, as had been proposed.